INTEREST RATE CAPPING AND PERFORMANCE OF FINANCIAL INSTITUTIONS IN KENYA: A CASE STUDY OF EQUITY BANK

By

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DECLARATION

This project is my original work and has not been presented for a degree in any other University. No part of this research should be reproduced without the authors' consent or that of the Management University of Africa.

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Declaration by the Supervisor

This project has been submitted for examination with my approval as university Supervisor.

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DEDICATION

I dedicate this project to James Kariuki Muchiri my loving husband for every support he has accorded me throughout my course period. To you my children Tracy, John, John, Debbie, Jane and Jane, it's from the peace and love you share that I get a reason to work harder for a better tomorrow.

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ABSTRACT

Banking operations in Kenya started in 1906 and for 86 years until 1992, interest rates in the financial institutions enjoyed capping. Following the Central Bank Amendment Bill (2000), the capping rate changed to interest rate spread of a maximum of 8%. In that year, Hon Joe Donde tried to introduce a bill towards rate ceiling without success (Dr. James et. al, 2000).In August 24, 2016, Kenya through a debate and signing of law by the President of Kenya adopted an interest rate capping law geared towards achieving its stability objective. The Central Bank of Kenya has the mandate through the monetary policy to regulate money supply. However, the parliament, an arm of the government through the legislators may bring a bill for debate which if passed and signed by the president, will subject it to law geared towards regulation as in this case. The research sought to answer the research questions of the study giving specific objectives. The study examined capping the rate of interest and performance of financial institutions, covering briefly its effects to profitability, loan portfolio, the impact to the labor force within the commercial bank, and the uptake of mortgage finance in relation to accessibility of the mortgage facility. The researcher adopted use of a descriptive design with a target population of96 Equity bank staff and customers. Stratified sampling method was used. Primary and secondary data were collected where interviews and questionnaires formed the main collection methods. Descriptive analysis included weighted averages, and percentages and data was represented infrequency tables, bar graphs and pie charts. The study found out that banks are focusing on mobile banking and government lending to counter the risk effects, while KBA is seeking to repeal the law; the central bank has been vocal on their willingness to retain the law. The study concludes that interest rate capping is not a long-term measure and recommends better policies and other applicable measures.

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ACRONYMS & ABBREVIATIONS

CBK	Central Bank of Kenya
MFC(s)	Mortgage Finance Company (ies)
MFI(s)	Micro-Finance Institutions
NBFI(s)	Non-bank Financial Institutions
AMFI	Association of Micro Finance Institutions
KIPPRA	Kenya Institute of Public Policy Research and Analysis
EGHL	Equity Group Holdings Limited
EBS	Equity Building Society
EBL	Equity Bank Limited
KBA	Kenya Banking Association
CEO	Chief Executive Officer
IMF	International Monetary Fund
CBR	Central Bank Rate
SSA	Sub-Saharan Africa
OMO	Open Market Operations
IRC	Interest Rate Capping
CBD	Central Business District
ROI	Return on Investment
WAEMU	West African and Monetary Union
ICPAK	Institute of Certified Public Accountants of Kenya
CRB	Credit Reference Bureau

DEFINITION OF TERMS

Interest margin- is the interest which the commercial banks use to fund their lending to customers.

Deposit margins -is the difference between a market rate and the rate of interest on deposits

Financial performance – is an indicator of how profitable a company is relative to its total assets and is measured by return on assets.

Monetary policy –is a macroeconomic policy under the central bank that is mandated by the management of money supply and interest rate with a macroeconomic objective.

Macroeconomic – is a branch of the economics that looks at the behavior of the aggregate economy such as inflation, price levels, national income etc.

CHAPTER ONE

INTRODUCTION

1.0Introduction

This chapter commits to examine the background of the study, review the profile of Equity bank a financial institution under the study, give a brief description of the statement of the problem, provide the objectives of the study and try to highlight questions regarding the research study. It also seeks to establish the purpose of the study, its significance, the limitations encountered as well as the scope of the study.

1.1 Background of the study

Performance of any financial institution is crucial for rapid growth of an economy and is measured through its profitability and shareholders' value.In any country's economy, banks acts as an intermediary where people deposit money and acquire loans with the difference between the rate charged on loans and the rate paid to depositors translating to the banks income. The interest rate charged by the commercial banks for instance, is determined by the market forces as much as by other market factors. Upward bank performance is a positive indicator on the economic growth and development of a country.For commercial banks, which are financial institutions that provide various types of financial services to customers in return for payment in form of either; interests, discounts, fees, commission and so on (M.Bhole, 2009), by providing these services, they participate in an economic activity, whose main goal is to generate income. On average, deposits from 80% of the source of bank funds and include savings, current accounts and fixed deposits. (KIPPRA, 2001), additionally, World Bank Business Survey-2016, reported that Kenya is ranked 28^{th} among 189 countries on Credit accessibility.

An interest rate in a financial sector is a rate that is charged or paid for the use of money. (Investor words, 2017). Interest rates are usually tied to a specified time and in many cases as annul percentages. The Central bank has the mandate to set interest rates through the monetary policies, as a tool for controlling a nation's economy and controlling the rate of inflation in the economy. In Kenya, interest rates averaged 14.16% from 1991-2017 reaching a one-time high of 84.61% in July 1993 and a record low of 0.83% in September 2003. (Taborda, 2016). Although the country was operating an interest rate spread of 11.4% for the past 20years, compared to the world average of 6.6%, there has been a protracted battle to cap the interest rates running back to President Moi's era, with arguments that it will lead to more people accessing credit facilities.

The Central Bank Governor, in his report on interest rate capping (2016), acknowledged that the interest rate that was being charged to customers on loans has been too high and that something needed to be done but he did not support the idea of capping the rates stating that doing so might discourage the banks from lending (Njoroge, 2016). While supporting the bill, the parliamentarians on the other hand argued that, interest rate capping is considered a policy intervention to drive down the cost of loans to the consumers, and the argument for it is a target geared towards bringing relief to the population against high interest rates charged by the banks. On 14th September 2017, the president of the republic of Kenya signed into law a bill capping interest rates to a rate between 10.5 and 14.5 per cent which is 4 percentage points above the CBR rate, on the money they lend to their clients. While there were applauds on the decision by many, the IMF Deputy Managing Director Zhang Tao said that the law complicated monetary policy and adversely affected the banking sector profitability especially the small banks, while Alistair Gould CEO African Alliance Ltd.'s Nairobi- based unit said, 'The new law will cause a decline in net interest margins by at least 200 basis points, causing banks to charge other fees to customers to make up for the lost income''.

1.1.1 Profile of Equity Bank

Equity Bank Kenya Limited is a financial services provider whose headquarters is in the Nairobi Central Business District (CBD). It is a subsidiary of Equity Group Holdings Limited (EGHL) that was founded in Kenya as Equity Building Society (EBS) in October 1984 and is the largest economy in the East African community, its original purpose was to provide mortgage financing to the low-income earners in the population, as well as promotion of agribusiness sector due to its rural banking orientations. In 2004, it converted into a fully-fledged commercial bank, the Equity Bank Limited (EBL), and in 2006, the Bank was listed in the Nairobi Stock Exchange where it has become the largest bank by market capitalization.

Over the years, the Group has built a social and economic brand that it has scaled up by providing financial services to the masses through a diversified distribution of its products and services. Locally, it has a unique approach to impacting the lives of the people in communities through its operations via existing infrastructure, enormous human capital and a strong brand. The Group's strategic initiatives and innovations are geared towards enhancement of access, convenience and affordability of financial services and have seen the group grow into a regional diversified services firm maintaining an impressive growth momentum and trajectory. The Group has established itself as the leading inclusive financial services provider with a strong base for Pan-African growth, thereby becoming a movement for social economic transformation of the people of Africa. Equity Group has transformed itself from a small building society into the leading financial services Group in the region and one of the most powerful brands in East and Central Africa which is in accordance to their slogan "Your Listening Caring Partner".

1.2Statement of the problem

Most people believe that capping interest rates will sustainably reduce the cost of credit as well as enhance transparency in fees charged on loans, but a closer look will show that financial accessibility is dependent on many other variables among them banks' business models that translates to fairly priced but better products, information regarding credit accessibility to the consumers, Reliable, fast and up to date credit reference bureau (CRB) and transparent and efficient Annual percentage rate (APR) that reflects the actual cost of loans, all of which must be addressed by the financial institutions as well as the Central Bank of Kenya on a continuous basis.

In Kenya for instance, we have 42 commercial banks but out of which six control 52.4% of the financial sector. Central bank has in the past argued that lending rates have been rising drastically in response to market conditions but on the other hand, banks have failed to reduce them when the market conditions reverse.CBK Governor argued that, regardless of the CBR and KBRR rates being 11.5% and 9.87% respectively in July 2017 and July 2016, the average lending rate in 2017 was averaging15.8% compared to 18.2% in July 2016.

Regarding a survey carried out by 2016 Fin Access Household Survey, the most common reason for taking credit by the population is to meet the day to day needs, with only over a quarter taking loans to support their businesses and Agricultural activities. Although many Kenyans are full of hope and expectations following the assented bill especially from lowered interest rate on their loans and higher earnings on their deposits, there have emerged some controversial issues from different parties with some seeing it as a solution towards protecting the borrower from exploitation, while some, see it as a way of discriminating the financial institutions especially the micro finance from lending.

The available research on capping rates in Kenya is either limited or very specific compared to that of neighboring countries, due to the fact that it's an emerging issue to the economy, most available research work focus is on other areas of financial sectors. Based on this fact and the major role played by interest rates in the Kenyan economy, this study seeks to examine the effects that will arise from capping interest rate in the banking sector. It also aims at finding solutions to the emerging issues that may arise from the action.

1.3 Research Objective.

The main objective of the study is to examine interest rates capping and performance of financial institutions in Kenya.

Specific Objectives

The specific objectives are as follows:

i. To find out the effect of interest rate capping on banks profitability
ii. To determine the rate of change on bank loan portfolio following interest rate capping
iii. To establish the effect of interest rate capping on staff layoff.
iv. To examine the variation on mortgage uptake in relation to interest rate capping

1.4 Research Questions

i. How does interest rate capping affect banks profitability?
ii. To what extent does capping interest rate affect the loan portfolio of a bank?
iii. How does capping interest rate contribute to staff layoff?
iv. To what extent does mortgage uptake suffer from capping interest rate?

1.5Justification and Significance of the Study

The researcher found a gap in the existing studies since there was limited information covering interest rate capping especially because the law is only less than a year old. The study will benefit the following;

1.5.1 Central Bank

The study findings will be used by the policy makers in the organization to come up with a better decision in relation to capping interest rates in the country. These policies will enable the banks performance to remain as competitive as usual since they will be based on actual study of their impacts.

1.5.2 The Researcher

This study will give the researcher an in-depth understanding of interest rate in the money markets and its effects to the players in the financial institutions. The researcher will also get a better understanding of banks operations and their impacts to the overall economy of a country.

1.5.3 The Commercial Banks

The commercial banks can use the findings to improve on the services available in the financial institutions, to ensure they are more efficient and effective in meeting customer needs. They will also seek to find ways that will mitigate the risks prevailing in the credit provision while ensuring ultimate transparency in their service to the clients.

1.5.4 Other Researchers

Other researchers in the industry can build on the knowledge of data and information gathered to articulate the way forward on other related issues not brought out, for the benefit of all parties outlined above. Additionally, the research study may help them in future as a source of secondary data when researching on related fields in different areas of the financial institutions.

1.6 Scope of the Study

The study was limited to Equity bank, selected branches in the Nairobi CBD and these provided sufficient and reliable data that the researcher used to make a conclusive analysis. Equity bank is of the tier banks and has very many branches within and outside the country, for this reason, the researcher decided on this bank for its market control in the money market and for its diverse nature in its operations mainly to both classes of customers and especially the middle class who understands the changes in an economy. The study coverage included Bank managers, credit managers, employees, and customers. The study target population was drawn from a target population of 96 participants. The researcher took three months to finalize on the study which commenced on April 2017.

1.7 Limitations of the Study

1.7.1 New law, less data

The researcher had few challenges acquiring data on interest rate capping in Kenya since the law is still at its inception stage making the available data almost insufficient. Additionally, there was other emerging issue such as a hard-hit economy which affected the money market making it very difficult to peg the consequences of the mediocre performance of the banks entirely on interest rate capping. The researcher used secondary data from publications as well as the financial markets institutions.

1.7.2 Pecuniary Difficulties

Collecting data from the bank branches which are located away from each other, buying the printing papers for questionnaires, printing them and Transforming the raw data to refined and internet accessibility led to excessive costs on follow-up. The researcher mitigated this by covering wide areas within a shorter period and utilizing the library for internet accessibility.

1.7.3 Lack of cooperation

It was very hard to convince the staff to share the required information, for fear of exposing information deemed confidential to the public. Additionally, postponing of the interview meetings earlier planned by some staff impacted negatively on time, finances. The researcher handled this by being persistent and consistent. Providing the introductory letter from school helped in building confidence from the managers.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter presents a review of the study literature. It includes an overview of the interest rate, theories that influence interest rate decisions, the financial performance of banks, and other related studies that have important arguments on effects of changes in interest rate policies in the performance of any economy. The review is a conclusive synthesis of these combined factors into a theoretical framework to guide the study.

In Kenya, interest rate management and control process is a task mandated to the Central Bank of Kenya (CBK), through the monetary program policy. As a money supply control strategy via the monetary policy, the CBK uses the Central bank rate (CBR), the open market operations (OMO), the reserve requirements by the CBK to the commercial banks and other existing instruments such as the rediscount facilities, short term deposit facility, and the discreet foreign exchange sales and purchases. This chapter is concerned about theory and the study of the interest rate as a money regulation policy.

2.1 Theoretical Review

There are several theories that try to explain the Interest rate study. Most of these theories focus on interest rate in relation to consumer behavior which is described using the demand vs. supply curve, and it states that demand is created by supply in any market. The theory of interest rate was first introduced by John Maynard in 1936 in his liquidity preference view theory. Other theories have been introduced to counter this theory.

To begin, interest is the fee that borrowers' pays to lenders for the use of their funds, while interest rate is the annual interest payment on a loan expressed as a percentage of the loan (Karl E.Case, 2002). One of the major theories of interest rates is the known as the classical theory of interest rate also known as the real theory of interest. Liquidity preference theory is another theory postulates that, interest rate as a reward of parting with liquidity, is seen as a measure of the unwillingness to those with the money to part with its liquidity control (Keynes, 1936).In his argument, John Maynard suggests that interest rate preference will be determined by the motive of the party, classified as either;(i) the transactions motive i.e. the need of cash for current transaction, (ii) the precautionary motive i.e. security desire of future equal value, (iii) and the speculative motive i.e. securing the profits from what the future will reap. He postulates that, the psychological expectations on the future interest rate affect the reaction of individual towards the liquidity preference.(Ahuja, Advanced Economic Analysis, 2006)

2.1.1 Liquidity preference theory

The liquidity preference theory was propounded by the late J.M. Keynes (1936) and it postulates that the rate of interest is the payment for parting with money. He states that this rate of interest falls with an increase in the quantity of money hence when many people have access to money, very few will be interested in borrowing and hence the interest charged to borrowers will be reduced as a tactic to woo borrowers to the lender. Additionally, a fall in the rate of interest may increase the quantity of money making a certain group of the population hold their money due to their future prospect also called the speculative motive. The main reason why quantity of money increases with a decrease in rate of interest, is mainly because borrowing becomes an affordable undertaking to many. The propensity to consume theory is driven by choices on what to consume and what to be reserved by an individual over a given period. Once the decision is made, there exists a further decision on the form he will hold the command over future consumption which he earlier reserved. In reality, this theory does not show us how the rate of interest is a return to savings since hoarding cash as a savings, earns a man no interest.

2.1.2 Classical theory

From the view of the Classical theory, the rate of interest is determined by the market forces at the point where the rate of interest from investment is equal to the amount of saving at that rate. This means that the rate of interest is fixed at the point where the supply of new capital is equal to the demand for it. To the classical economists, the role of real factors such as abstinence or waiting, time preference and productivity of capital are determination for interest. In the classical theory, Knight and J.B.Clark explained the phenomenon of interest only from the view point of the demand for capital while they laid less emphasis on productivity of capital. Irvin Fisher and Bohm-Bawerk argued using time preference on supply side while productivity was placed on the demand side to determine the interest (Ahuja, Advanced Economic Analysis, 2006).The classical theory therefore seeks to explain that rate of interest is determined by the supply of savings and demand for savings to invest. However, this traditional theory fails to show the behavior of the market with changes in interest rate through its assumption that there is always full employment of the resources in the economy. With full employment, this theory postulates that, all resources including the labor force is fully underutilization within the economy with everything required for production being readily available. It is unlikely that an economy can truly enjoy full employment.

2.1.3 Loanable funds theory

Another theory of interest rate is the loanable funds theory by the neo classical economists such as Knut Wicksell, Haberler, and Robertson Viner etc. Loanable funds are defined as the sums of money supplied and demanded at any time in the money market. In this theory, the economists argue that there is an interplay of both monetary and non-monetary forces in determination of the rate of interest. (Ahuja, Theory of Interest Chapter 52, 2006). Wicksell on the other hand suggest that the market rate of interest is determined by the demand for and supply for loanable funds/ credit whereby the theory seeks to improve upon the classical theory of interest rate. It postulates that demand for loanable funds arises for the following purposes; for investments, saving and for consumption.

2.1.4 Ricardo's principle of political economy theory

This theory states that interest of money is not regulated by the rate at which the bank will lend, but by the rate of profit which can be made by employment of capital and which is entirely independent of the quantity of the value of money. The Ricardian theory clearly explains that there will be only one rate of interest that is compatible with full employment in the long run, and that for banks to make money there needs to be a measure of comparison between the rate of profits to be made and the rate of interest they intend to lend it. However, the theory overlooks the fact that even in the long period, the volume of employment is not necessarily full but is capable of varying, and to every banking policy, and there is a corresponding long period of employment amongst which corresponds to different conceivable interest rate policies on the part of monetary authority. (John Mill, 2012)

2.1.5 Neo classical theory

For neo classical theory, Professor Von Mises and Prof Hayek (2008) postulates that changes in the rate of interest rate is easily identified with changes in the relative price level of consumption goods and capital goods. From this argument, an individual's saving will lead to a reduction in prices of consumer goods and most certainly an even greater decline than the price of producer goods.

2.2 Empirical Literature Review

According to World Bank survey there exist few studies on interest rates in Africa and Kenya in particular. In one of their research papers, world bank established that majority of the countries in the region have a certain kind of ceiling with SSA reporting the highest number amounting to 24 or 50%, closely followed by LAC 14 of 48%, EAP had 7 or 44%, MENA 6 of 29%, while SA had 3 countries totaling to 38% of the countries with interest rate ceiling. Mohsin (2010)carried out a research on the design and effects of monetary policy in sub-Saharan African countries, Ngugi(2001,2003) analyzed interest rate spread in Kenya and in sub-Saharan Africa between 1993-1999 where the study observed that credit risk, low competition from alternative financial sources, fiscal policy, deposit availability and profitability as the main determinants of interest rate spread while Kiptui (2010) carried a research study to examine major determinants of interest rate spread. In his study, he identified that operating costs, non-performing loans, exchange rate variability and treasury bills highly determine interest rate spread. From available study, it is clear that there is narrow coverage of the study on interest rate capping and specifically its impacts to the performance of financial institutions in Kenya. (Randa, 1998), Many studies in the banking sector in Kenya have their focus bent on financial and non-financial institutions performance. However there exists limited research work on the role of Central bank in controlling the money market via the monetary policies and precisely a mention of the interest rates (KIPPRA, 2001).

World Bank on its research working paper (WPS7070) on interest rate established that, 76 countries around the world are currently using some form of interest rate caps on loans out of which 61 are members of the World Bank with 28 of them using the usury laws, 24 uses the interest rate laws and at least 9 countries uses de facto ceilings for authority. (Samuel Maimbo et al., 2014). Although many countries may qualify to adapt the capping laws, some of the unique features that exist with most countries using interest rate caps include; most have a single financial sector regulator such as the Central bank, have legislation on financial consumer protection, their GDP ratio to credit is relatively low while their banking system is characterized by existence of state owned banks.

In many cases, the government uses interest rate caps to provide support to a specific industry or areas of the economy (Miller, 2013). On the other hand, the World Bank in their research study established that, many countries adapt interest rate ceiling to protect consumers from high interest rate charged by the banks. In sub-Saharan Africa (SSA), study shows that there are 24 countries that are already using the interest rate caps. For instance, the West Africa and Monetary Union (WAEMU) countries established interest rate capping in 1997 but later on in 2013 dropped their ceilings by 3%. Currently these banks can charge a maximum of 15% while the microfinance can charge up to 24 %. In 2013, Zambia introduced a cap on commercial lending at 9% points over the policy rate which left their interest rate ceiling at 42% for Non-Banking Financial Institutions (NBFIs) while those charged by the other NBFIFs could not exceed 30 %, the effect was a near collapse of the credit market i.e. credit to households and to SMEs. It also culminated to a hard-hit local currency that could not participate in the foreign exchange market which led Zambia to repeal the law in November 2015. In developed countries such as countries in Latin America, e.g. Ecuador capping interest rate led to flourishing of illegal lending while in Mexico and Chile, there has been a notable reduction of lending to the poor and vulnerable and their economies are still lagging behind in the financial inclusion agenda.(Olaka, 2017).

Interest rate capping is found to be necessary in the markets that lack transparency, have limited disclosure requirements and those with low level of financial literacy. Empirical evidence suggests that there is existence of connection between interest rate, companies' profitability, loan portfolio, staff layoffs and mortgage performance. Capping of interest rates in Kenya has been necessitated by the perception of skewed model of credit pricing which the banking sector has been employing (Legislators).Whiledefending against interest rate capping, the Kenya Bankers Association (KBA), argued that higher interest rate is not pegged on power control but rather on the risk involved and therefore capping interest rate might exclude some borrowers from accessing credit (2013).Although capping rates looks good, it is important to note that if set too low, it may hurt the low-income population through the inability to access funds, reduction of service delivery to the rural areas by the banks and hence become hard to recover costs which translates to slow growth of the economy.

2.2.1 Profitability and interest rates

Profitability refers to a company's ability to generate earnings (Thomas P. Edmonds, 2008). It is a performance measure that arises when the revenue from products and services exceeds expenses incurred. Profit is measured using three different metrics namely; the gross profits, operating profits and net profits. While calculating a company's profitability, managers must understand the causal linkages between inputs, processes and outputs (Simons, 1999). Banks profitability is affected mainly by the difference between the lending rate and the interest margin. Normally the central bank through the monetary policy ensures that interest margins are not as high as the lending rates. This policy is geared towards protecting the consumers. On the other hand, banks deposit margins are affected by the lowered interest rates leading to a negative impact on profitability. However, the extent to which the deposit margin affects profitability depends on how much a bank depends on deposit as a funding source. (Riskbank, 2016).

Looking at profitability of a financial institution for instance, low interest rate resulting from the law on capping interest on loans will encourage borrowing since many customers will feel convinced that its affordable and this will increase the cost of funding the loans as well as increases the credit risk in the banks. When risks are high, then insuring them becomes a costly undertaking and all these issues will translate to decreased returns on profits. The increased risks will consequently lead to an upsurge in the cost of funds i.e. operations and processing costs which eats on the banks profitability. The main reason associated to this risk is uncensored borrowers who are classified as very risky. Additionally, the banks cost of processing the loans might increase due to increase in the number of borrowers seeking small loans, and since the interest charges are reduced, there will be a negative effect on the banks profitability.

Addressing shareholders on Equity Groups profits for the fiscal year ended 31, 2016 that recorded a drop of 4percent to Sh16.5 billion, the Group Chief Executive James Mwangi (2017) said "Introduction of interest rate cap had complicated the business environment making it hard to price some of the customers, such as small enterprises". (Mwaniki, 2017).He added that the bank has a cost of risk that it cannot pass to the borrower which is eating into banks profitability. (Okoth, 2017). In his statement, Equity Bank said that it is planning to grow its alternative channels of transactions hence translating to higher cost saving which is geared towards enhancing the bank's profitability. When many people have access to funds affordably, there will be an upsurge in consumer expenditure and this reduces savings by consumers, which affects the running of a bank. Additionally, when the rate of interest increases for customer deposits, many customers will be interested in saving to target the interest and this will have a negative effect on consumer expenditure. Such a law which sets interest on deposit at 70 per cent will consequently have a negative effect on the banks profitability.

2.2.2 Loan Portfolio and Interest Rate

A loan is a debt provided by an entity to another entity at an interest rate and evidenced by issuance of a promissory note specifying clearly the principal amount borrowed, the interest rate the lender is charging and the expected date of repayment. It is also defined as anything that is borrowed especially a sum of money that is expected to be paid back with interest. Loan portfolios are mainly the assets of a bank and their value depends on the principal and interest owned and the average credit worthiness of the loans. Banks referred here as the creditors make money by lending money in form of loans at agreed terms and against specified collateral. They are mainly interested in whether a company will be able to repay the debt on time through investigating the company's liability percentage, since as Thomas et.al (2008) describes in their book, the larger the liability the greater the risk that the company might fall behind or default on debt payment. While lending the money therefore, the bank ensures they evaluate the credit worthiness of a potential borrower before approval.

There are distinct types of lending practices in a bank; Investment lending, consumer lending, auto lending i.e. residential mortgage and recently home equity lending. Although loans are the primary use of bank funds and the principal source of their income, they bear varying degree of risks which the banks must be willing to absorb in case of default. Due to the substantial risk involved in lending, banks prefer lending to minimal risk customers such as major business entity and to the government using bonds also known as secured debt. Recently, access to financial services has been identified as a significant issue many are experiencing in attempts to fund their existing or even for startup businesses.

The main purpose of the credit is to bridge the gap between what a business or an individual has in terms of assets and what is required for smooth operation of the enterprise. However, there is always an existing imbalance on the same which leads to demand for credit. According to Aryeetey et.al (1994), demand for credit falls under either; perceived, potential and revealed demand. Perceived demand is felt only when the entrepreneurs are in need of cash and see it as a financial constraint. Potential demand is when there is an expressed desire for credit that isn't acted upon in spite of market imperfections and institutional barriers while revealed demand occurs when entrepreneurs with projects apply for credit at prevailing interest rate.

The accessibility to credit in commercial banks is controlled by the legal and regulatory factors as well as individual banks policies which exist to counter the risks associated with factors such as culture, attitude and lengthy and cumbersome loan recovery procedures. Banks must ensure there are enough funds at any given time to avoid situations where customers want to borrow but cannot access. This availability of funds is enhanced by increasing deposits from customers as well as from the accumulated interests from already serviced loans. According to (Eigen.J., 1999) lending by the banks requires one to provide a form of security which is used in case of default by the customers. However, some applicants without any form of collateral to secure the loans, disadvantage the banks in that they are unable to adjust the interest rate upwards for the unsecured loan hence losing in case of interest rate changes while the company benefits from a cheaper rate of credit for non-adjustment hence gaining from transfer of value. It is also very important for the financial institutions to check on a company's liquidity ratio or its solvency ratio to be sure of a company's ability to satisfy its obligation. With reduced income from the capped interest rates, many banks have decided to lower their lending base by introducing very strict regulations and conditions which are not achievable by the customers seeking credit financing. Many customers seeking credit are usually in the SMEs and Medium enterprises who may not meet all the requirements of the banks making it difficult to even acquire mortgage funding.

2.2.3 Mortgage uptake and interest rate

Although introduction of the interest rate caps attracts more borrowers for an affordable credit facility, reports shows that many commercial banks have decreased their lending hence denying customers housing funds while they concentrate on low risk funding especially with the government.

ICPAK's opinion is that the banking sector formally operated an oligopolistic market where credit pricing did not reflect market fundamentals (Barasa, August 2013). Following the banking amendment act that capped the interest rate, the banks have been pilling pressure on the government to scrap the rate controls arguing that, they have reduced credit lending to the private sector and consequently have failed to increase savings as had been anticipated. (Guguyu, 2017) Since introduction of the cap, many banking institutions have recorded a drop in their borrowings arguing that the cap has made it difficult to price for risks (KCB CEO).ICPAK in their study also established that SMEs lending relative to total lending by commercial banks is higher by 23.4% compared to other major markets in sub-Saharan Africa (2016).

2.2.4 Staff Layoff and interest rate

Layoff is defined as termination of duties of an employee by an employer without the staff faults. The major reasons for layoffs have been associated to lack of enough work for all existing employees, lack of funds or as a cost cutting strategy and lastly from organizational change. In many instances, staff layoff in the work place may have been because of increased competition in the market, reduced demand for the commodities or services and high inflation rate. Staff layoff in a financial institution is seen to arise from lack of funds or as a cost cutting element and is usually a very genuine issue in any organization bearing in mind that a company invests highly on training the employees as well as in investing in their welfare.

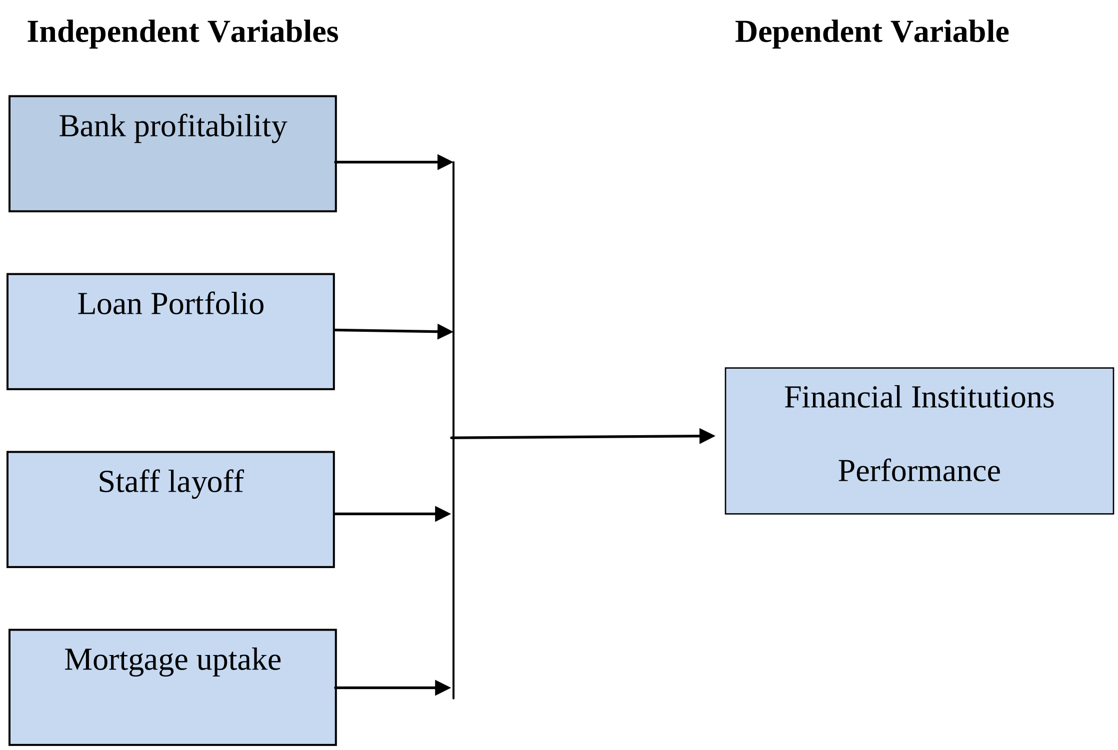
Interest charged by the banks consists of their main source of income. When banking income is high then, they will be able to cater for all their operational costs while low income means inability to handle the costs. Staffs are considered a major resource in any organization and which must be maintained for the smooth running of the organization. Many large organizations such as banks ensure they train their staff as a way of boosting their productivity. However, this by itself is a very expensive undertaking which requires a lot of financial investment and commitment that can only be managed with sufficient funds.

2.3 Research gaps

Interest rate is the most visible and palpable power source of many modern commercial banks and which the Central Bank of Kenya uses to control the fiat money as necessary. Looking at liquidity, the focus on aligning the finance and accounting role in the strategic plan of a financial institution is very crucial, hence the need to understand the interest rate a bank is willing and able to charge at any given time. While looking at the study on capping interest rates and the effects it will have on the financial institutions, the researcher focused on banks profitability, the loan portfolio in the banks, the effects on the workforce as well as how it will bring variations on accessibility and acquisition of mortgage to the population.

Since the introduction of the capping law there has been little research on the impacts of the law to the country's economy. However, it is evident that KBA has issued a report on the intended consequences of the law however; there have been some emerging challenges within the financial institutions and to the economy at large as experienced in other regions that embraced ceiling in the past. For instance, in Nicaragua, a study by Alfredo Alaniz found out that member institutions portfolio growth fell from 30% to 2% when the ceiling was introduced. In West Africa, when interest rate was capped at 27% for MFIs, some MFIs withdrew from more poorer and very remote areas to the urban centers that are seen to be an easy customer base. Lastly in S.A, credit law review found out that introduction of IRC didn't effectively protect consumers as had been anticipated. It is therefore wise to give the law some time to observe what may happen over time. It is also important for the necessary bodies to undertake a considerable research on the major outcomes which will emerge as a result of the capped interest.

Figure 2. 1 Conceptual Framework



Source: Author (2017)

2.5 Operationalization of Variables

Bank Profitability

Profitability is the ability of a company to generate earnings. It is a performance measure that arises when the revenue from products and services exceeds expenses incurred. Banks profitability measured from net earnings against expenditure gives a net income. i.e. P=I-E where P is profit, I is income and E is expenditure incurred.

Loan Portfolio

Loan portfolio is the largest asset and predominantly the major source of her revenue. The funding to their customers becomes their loan portfolio which in accounting is known as banks liability and is determined by pricing as well as maturity decisions in relation to the cost or expected risk.

Staff Layoff

Layoff is defined as termination of duties of an employee by an employer without their faults.Staff layoffs are noticeable by comparing first the number of empty tills in a bank as well as the number of branches that have been closed from January 2017

Mortgage Uptake

Mortgage is defined as the transfer of a legal or equitable interest in a specific immovable property for the payment of debt. The real estate market has been stagnant with slow growth since January and specifically in the purchase of new units.

2.6 Chapter Summary

This chapter looks at the existing literature related to interest rate capping and specifically covers the major theories that explain the history and application of interest in major economies. From the study, the researcher looks at prevailing conditions before the caps in some of the countries in Africa and compares that with the emerging issues after the capping and concludes that although capping rates is a good short-term goal, it may have very severe long-term effects which may not be reversed easily. It is also established that the transparency goal that the law seeks to achieve may not be achieved since the banks lacks a clear policy on their transparency objective which should determine how much they are eligible to charge to achieve their set margins.

From the literature review, most of the countries that had embraced interest rate ceiling in the sub-Saharan Africa and in Latin America ended up reversing the laws while a substantial number of them adapted different rate caps for different classes of loans. It is therefore necessary for the participants mandated to formulating such laws to study the emerging trends in other countries that have practiced ceiling laws as well as involve all the stakeholders if they intend to reap better result in protecting the consumers.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

The chapter clearly outlines the methodology of research study that the researcher used in collecting objective data which led to the successful attainment of the researchers' objectives as well as in answering the research questions. This chapter illustrates clearly the research design, the target population, sample and sampling techniques, data collection procedures as well as the instruments of data collection and its analysis.

3.1 Research Design

A research design is a scheme plan or an outline that is used to generate research problems. Another researcher observes that a research design is a structure that glues or holds all elements in a research project together. The research design used by the researcher is descriptive because it describes data and characteristics about the population phenomenon being studied. Coopers and schidler (2004) observes that descriptive studies are more formalized and clearly typically structured with clear investigative questions. According to Cooper 1996, a descriptive study finds out who, the what, where and how of an event which is the main aim of the study.

3.2 Target Population

In statistics, target population is defined as the specific population about which information is desired. According to Mugenda a population is a set of people, cases, or objects with some common observable characteristics. (Mugenda, 2003). This makes the coverage homogeneous in nature. The target population consists of 96 people comprising of Equity bank staff from branches in the Central Business District and some of their customers who together make up the unit of analysis. Equity bank is the point of observation. However, due to large numbers of the branches within the CBD, a random sample of representative branches was selected. This as cooper and schidler argues, if well chosen, a sample of about 10% of the population often will give a good reliable data.

Table 3. 1 Target Population

Category	Frequency	Percentage

Equity bank staff	60	62.5%
Equity bank customers	36	37.5%
Total	**96**	**100%**

Source: Author (2017)

3.3 Sample and Sampling Technique

A sample is a group obtained from accessible population while sampling is the process of selecting the number of individuals for a study in such a way that the individuals represent a larger group from which they are selected. Sampling technique is the procedure a researcher uses to gather information to study the people, places, or things.

The researcher used both random sampling technique and stratified sampling techniques. Random sampling technique was used to acquire data through questionnaires from the customers who were picked randomly as appeared in the banking halls. This technique was preferred because it’s least biased, not subjective and each member of the population has an equal chance of being selected. Additionally, stratified sampling technique was used because of the available subsets of the population in the study which involved both the customers and the staff, in order to get a sample that is proportional and representative of the population.

3.4 Instruments

They include the tools or ways of gathering data. The researcher opted on using questionnaire as the primary tool because this facilitates data gathering and is easy to test for reliability and validity, requires less time and preserves anonymity and confidentiality of the respondent. There was also use of face to face structured interviews. The choice was necessitated by the need to verify data gathered as well as need for clarification on certain explanations. Other instruments used included available secondary data obtained from online materials and existing books. Observation was also used where necessary.

3.5 Validity and Reliability Test

The researcher undertook to carry out a pre-test study to validate the questionnaire. In research, a pilot group can range between 25 to 100 subjects depending on the methodology selected if it exempts the need for statistical data. In line with this requirement the use of qualitative research design methodology has been used for data collection. The reason why the researcher has opted on the use of this is because it gives more reliable information since it involves open ended questions where the participant discusses their answers.

Research study requires that there is validation of data as a measure of accuracy between the data collected using a certain instrument and the content of a particular concept. That is evidenced by providing open ended questions to the participant to allow them support and hence validate their answers.

3.6 Data Collection Procedures

The questionnaires that the researcher had developed were sent to selected sample groups and respective sub group that comprised of staff and customers of Equity bank within the CBD. To collect dependable data the researcher allowed the participant enough time to fully complete the questionnaires and collected them at an agreed day. After collecting the already filled questionnaires the researcher evaluated and reevaluated the data to assess its reliability and eligibility.

3.7 Data Processing and analysis

Quantitative data collected via the questionnaires was first edited for relevance and later coded for easy classification and to facilitate its easy tabulation. After presenting the data in the tables, it was then analyzed quantitatively to establish the appropriate percentages in each of the questions where possible these were then presented through use of pie charts and bar graphs for clear interpretation and to enhance successful conclusion of the findings. For the qualitative data that had been collected using descriptive methodology, analysis was done and afterwards it was clearly outlined using explanatory notes in the summary and conclusion sections.

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION OF FINDINGS

4.1 Introduction

This chapter discusses data analysis, presentations and interpretation of the research findings. The chapter gives detailed explanation of the processes, techniques and procedures applied to analyze and present data acquired using questionnaires.

4.2 Presentation of findings from staff and customers general information

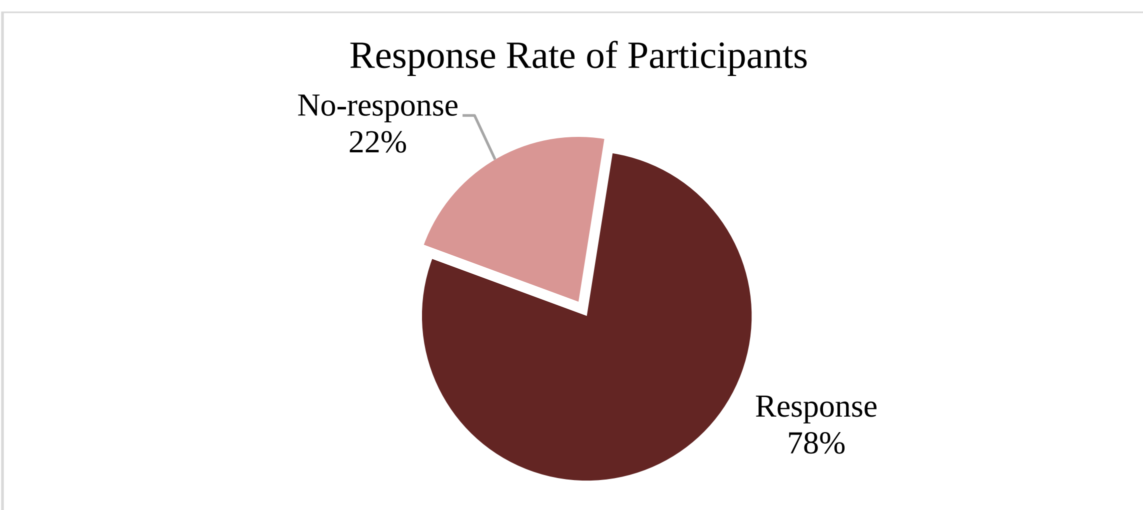
4.2.1 Presentation of Response Rate

Table 4. 1 Response Rate of Participants

Category	**Frequency**	**Percentage**
Response	75	78%
Non-response	21	22%
Total	**96**	**100%**

Source Author :(2017)

Figure 4. 1 Analysis of Response Rate



Source: Author (2017)

Table 4.1 and Figure 4.1 above show the number of questionnaires issued by the researcher. Based on the analysis, 75 participants comprising of 48 Equity bank staff and 27 Equity bank customers accounted for 78% of the respondents who filled and returned the questionnaires for data analysis, out of the remaining 21 respondents who received the questionnaires, 13 of them never returned their questionnaires while 8 returned their questionnaires incomplete amounting to 22%. The analysis concluded that majority of the respondents participated in the study.

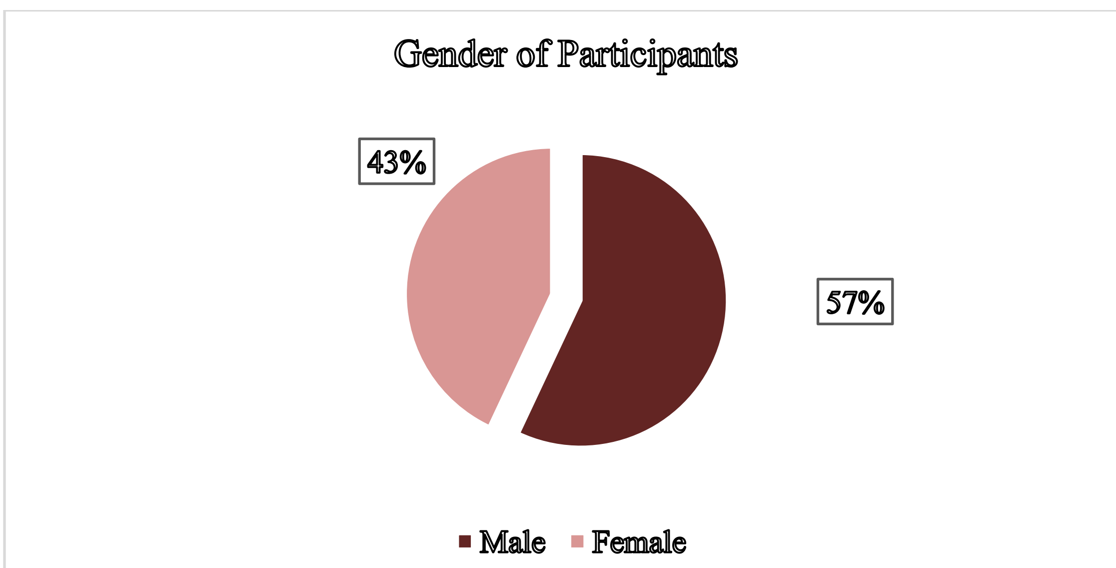
4.2.2 Gender Analysis

Table 4. 2 Gender of Participants

Category	Frequency	Percentage
Male	42	57%
Female	33	43%
Total	**75**	**100%**

Source: Author (2017)

Figure 4. 2 Gender of Participants



Source: Author (2017)

Table 4.2 and figure 4.2 above show the gender of the respondents who participated in the study, based on the analysis, those who participated in the research included 43% female while 57% were male therefore, it is evident that majority of the participants in the research were male.

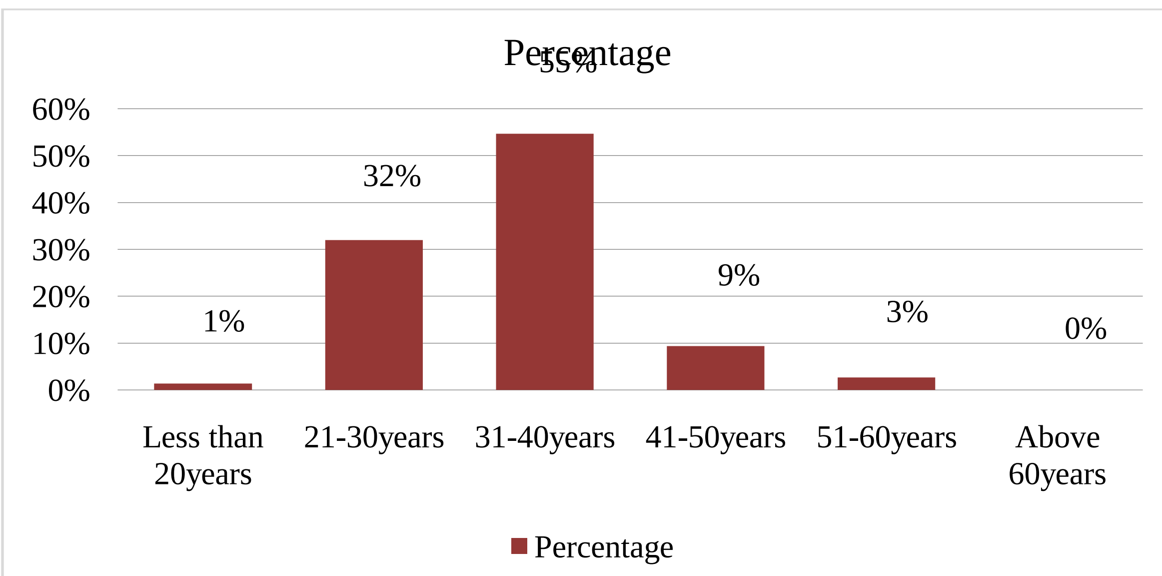
4.2.3 What is your age?

Table 4. 3 Ages of Participants

Category	Frequency	Percentage
Less than 20 years	1	1%
21-30 years	24	32%
31-40 years	41	55%
41-50 years	7	9%
51-60 years	2	3%
Above 60 years	0	0%
Total	**75**	**100%**

Source Author: (2017)

Figure 4. 3 Ages of Participants'



Source: Author (2017)

Table 4.3 and Figure 4.3 above indicate the age of the respondents and based on the findings, only 1% of the respondents were less than 20 years old, between ages 21 – 30years were 32%, 55% were between ages 31 – 40, 9% were between ages 41 – 50 years, 3% of the respondents were between 51-60 years while none of the participant was above 60 years of age. The study therefore concludes that most of the participants were mature adults between 31years and 40 years of age.

4.3 Presentation of Data from Equity Staff

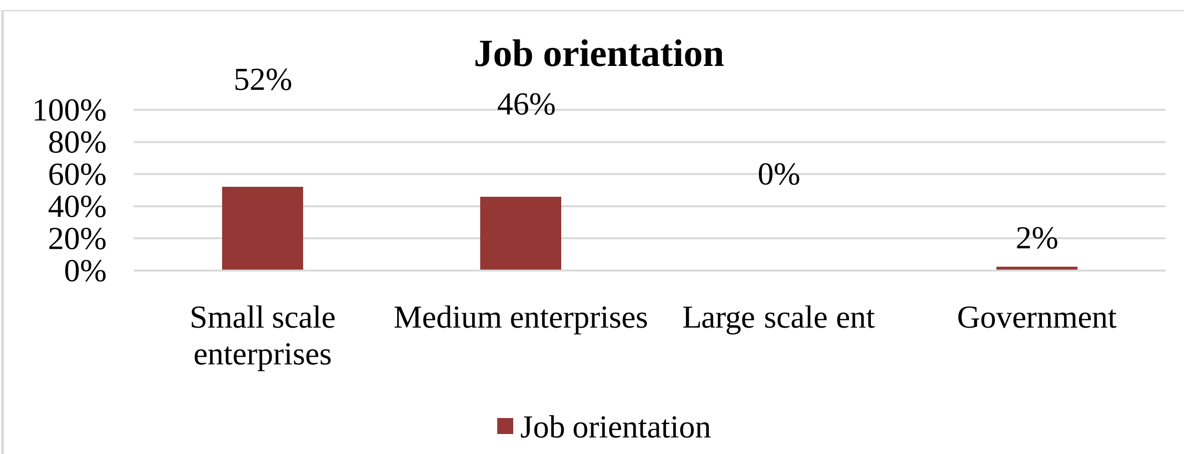
4.3.1Who in your opinion makes up major credit borrowers in the bank?

Table 4. 4 Classification of Bank Customers

Description	**Frequency**	**Percentage**
Small scale enterprises	25	52%
Medium scale enterprises	22	46%
Large scale enterprises	0	0%
Government	1	2%
Total	**48**	**100%**

Source: Author (2017)

Figure 4. 4 Analysis of Bank Customers



Source: Author (2017)

Table 4.4 and Figure 4.4 above indicate the opinion of the bank staff on which their majority of the customers are. According to the analysis most of them 50% observed that majority of their customers are in small scale enterprises with 48% arguing that their customers were mainly in Medium enterprises. Only 2% of the respondents felt that majority of their customers come from the Government. The study concludes that 98% of the banks received more customers from the small and medium enterprises.

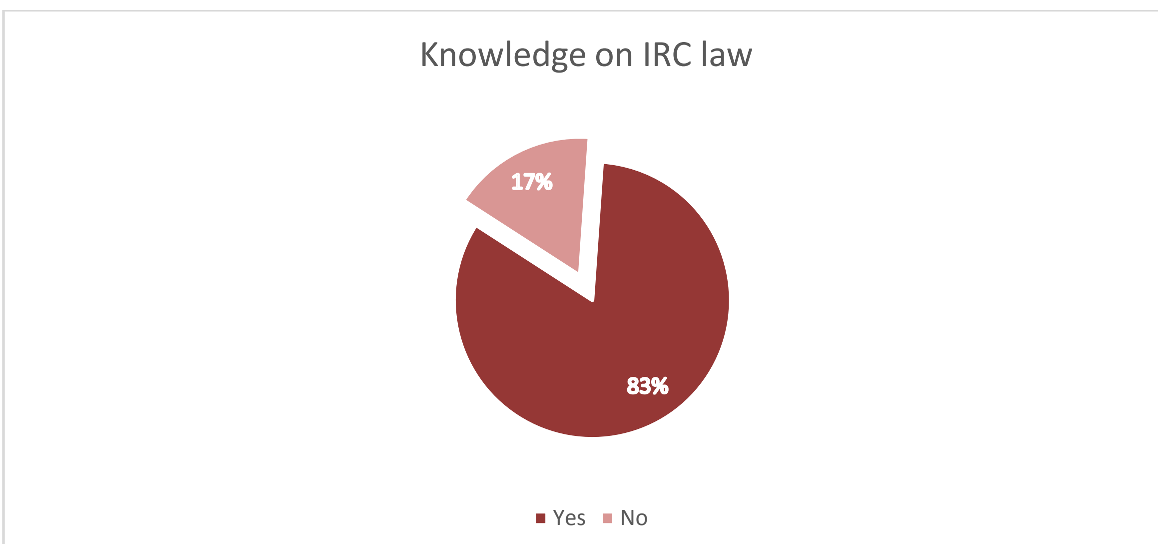
4.3.2 Do you know about the recently introduced law on interest rate capping in Kenya?

Table 4. 5 Knowledge on IRC Law

Category	Frequency	Percentage
Yes	40	83%
No	8	17%
Total	**48**	**100%**

Source: Author (2017)

Figure 4. 5 Knowledge on IRC Law



Source: Author (2017)

Table 4.5 and figure 4.5 above shows the number of participants with IRC knowledge or at least had heard about the IRC law at the time of the research study. It is clear from the analysis of 83% against 13% that majority of the respondents had heard about IRC.

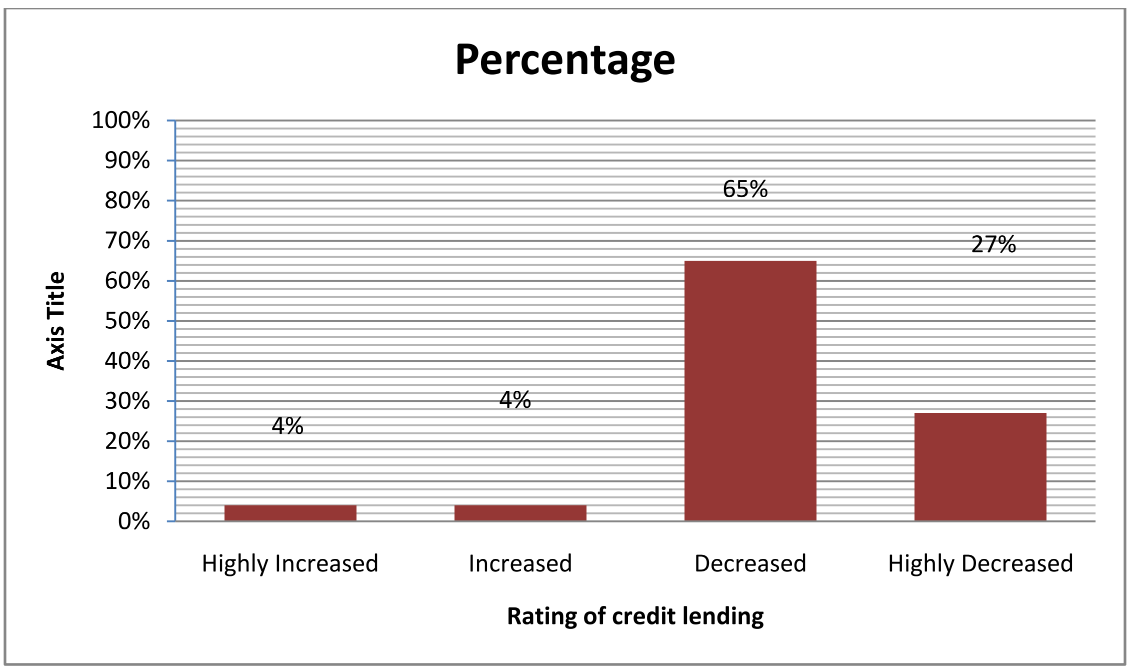
4.3.3 How would you rate credit lending since introduction of the interest rate caps?

Table 4. 6 Rating of Credit Lending since IRC Law

Description	**Frequency**	**Percentage**
Highly increased	2	4%
Increased	2	4%
Decreased	31	65%
Highly Decreased	13	27%
Total	**48**	**100%**

Source: Author (2017)

Figure 4. 6 Rating of Credit Lending



Source: Author (2017)

From table 4.6 and Figure 4.6 above, 65% of the staff respondents stated that credit lending had decreased, 27% of the staff believed that lending had highly decreased while only 8% of the respondents argued that it had either increased or had highly increased. It is therefore conclusive to state that majority of the respondents at 65% agreed that credit lending had decreased since the introduction of the IRC law.

4.3.4 Does Interest Rate Affect Loan Repayment ability of the Customers?

Table 4. 7 Interest Rate Charged Effect on Loan

Category	Frequency	Percentage
Yes	32	67%
No	16	33%
Total	**48**	**100%**

Source: Author (2017)

Figure 4. 7 Effect of Interest on Loan Repayment

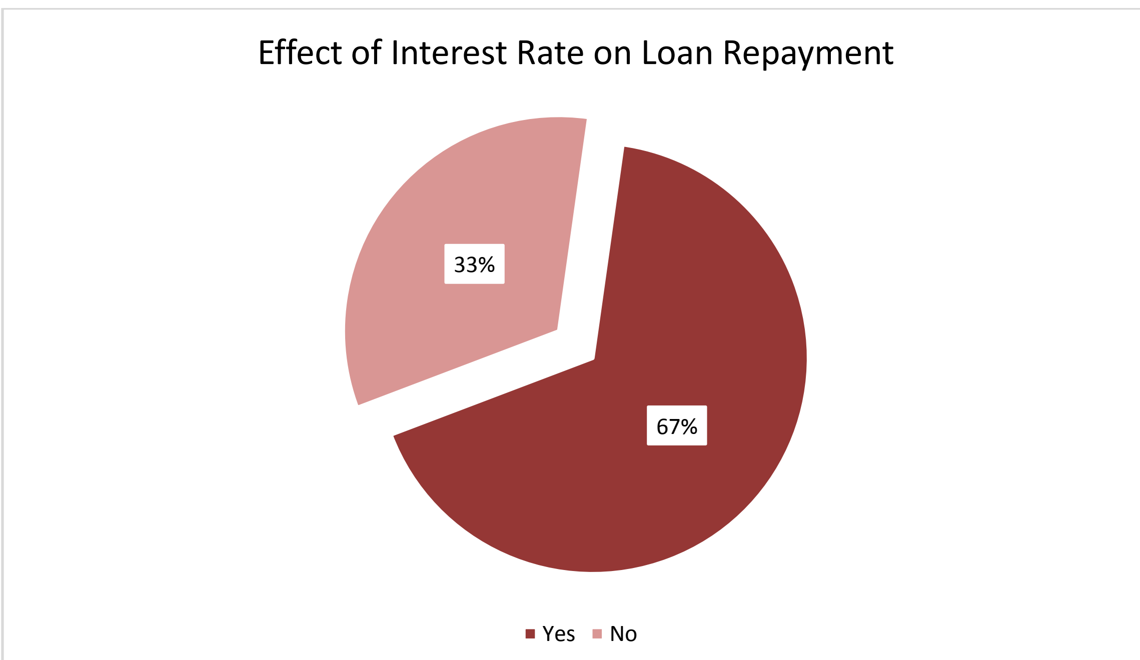


Table 4.7 and figure 4.7 shows the bank staff opinion of whether interest rate had any effect on loan repayment ability. From the data collected majority of the staff who responded at 67% argued that interest rate plays a key role on one's ability to repay the loan arguing that low interest charged translates to high repayment ability, while 33% said interest rate didn't have any effect on one's ability to repay the loan, with some factors such as funds diversion being mentioned as one of the determinants.

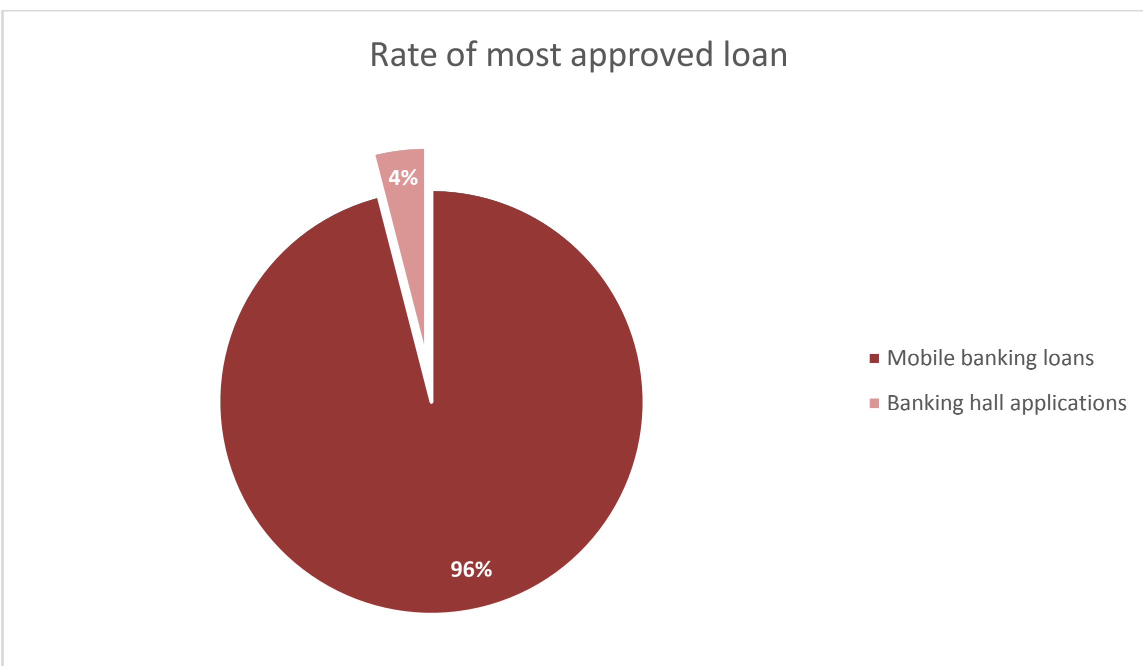
4.3.5 Which in your opinion has received more of loan approvals since IRC?

Table 4. 8 Most Sought and Approved Loan

Category	Frequency	Percentage
Mobile banking loans	46	96%
Banking hall application	2	4%
Total	**48**	**100%**

Source: Author (2017)

Figure 4. 8 Analysis of Highest Approved Type of Loan



Source: Author (2017)

From the table and figure 4.8 above, 96% of the staff argued that since introduction of the IRC law, majority of the loan approvals were concentrated on mobile banking with a partly 4% stating that banking hall application loans were still high even after introduction of the IRC.

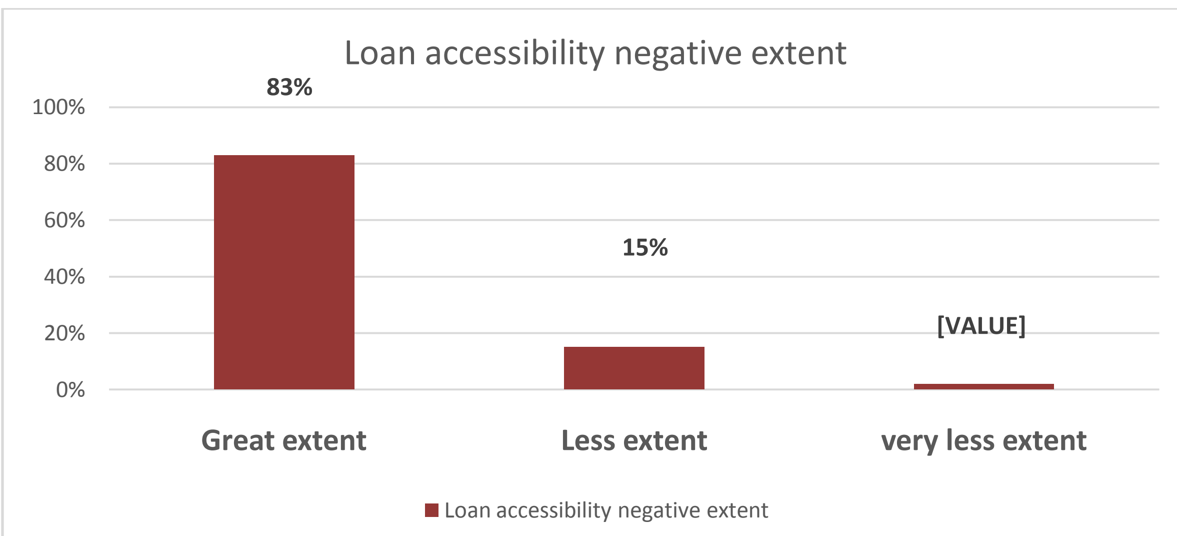
4.3.6 To what extent has loan accessibility been negatively affected by the IRC law?

Table 4. 9 Extent to which loan accessibility has been negatively affected

Category	**Frequency**	**Percentage**
Great extent	40	83%
Less extent	7	15%
Very less extent	1	2%
Total	**48**	**100%**

Source: Author (2017)

Figure 4. 9 Analysis of effect of law on loan accessibility



Source: Author (2017)

From the table and figure 4.9 above, according to 83% of the bank staff, loan accessibility has been greatly affected negatively by the newly introduced IRC law. 15% of the staff argue that the extent loan accessibility has been negatively affected is small. From the data analysis, therefore majority of the bank staff feels that loan accessibility has been negatively affected by the law at a great extent.

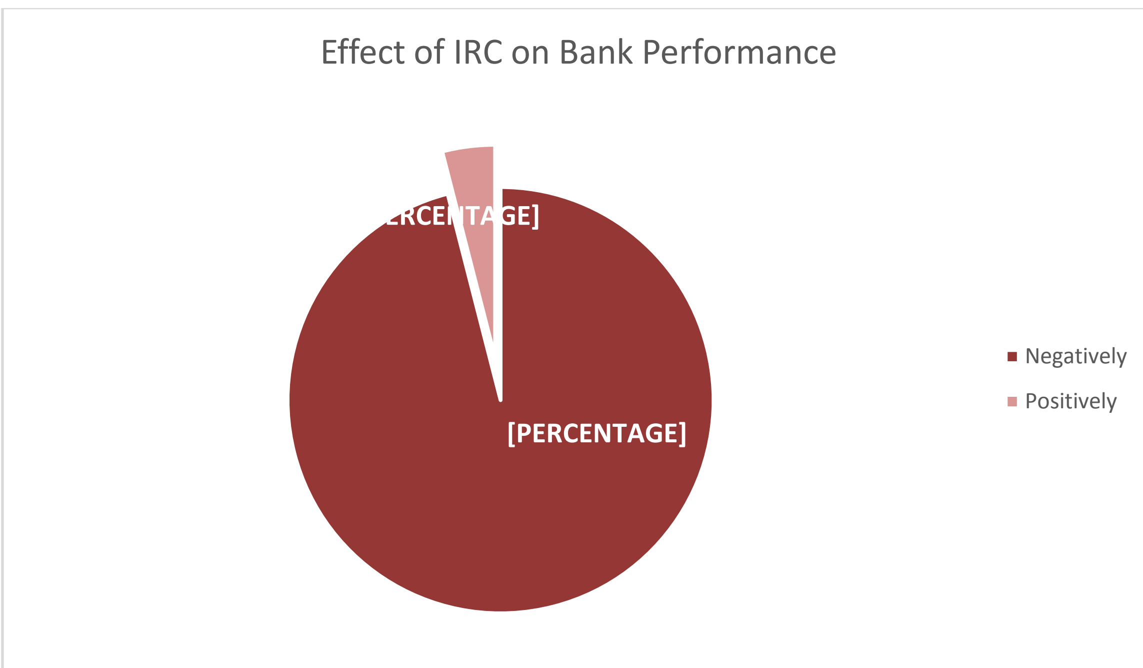
4.3.7How in your opinion has the law affected bank performance?

Table 4. 10 Opinion on how Bank performance has been affected by the law

Category	Frequency	Percentage
Negatively	46	96%
Positively	2	4%
Total	**48**	**100%**

Source: Author (2017)

Figure 4. 10 Analysis of IRC effect on bank performance



Source: Author (2017)

According to table 4.10 and figure 4.10 above, 96% of the staff argued that bank performance had been negatively affected since introduction of the IRC law with only 4% of the respondents saying they think the law affected bank performance positively. Based on this data therefore, high number of staff believed there was a negative effect on banks performance.

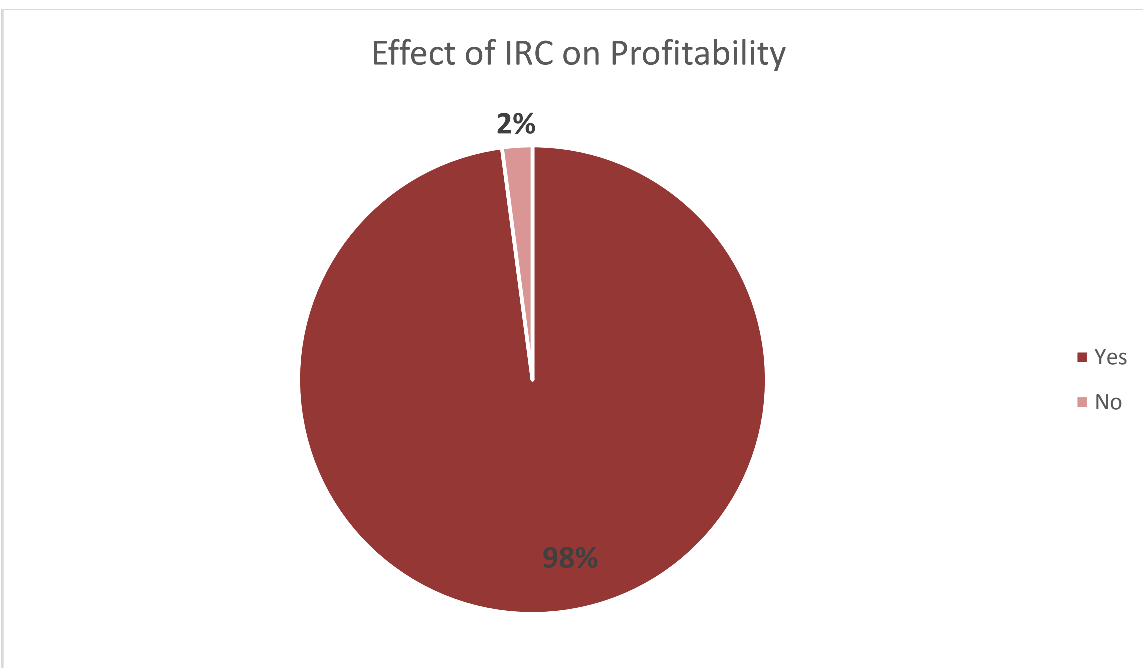
4.3.8Do you think IRC has contributed to the reduced profitability of the banks first quarter (1st Quarter) results?

Table 4. 11 Response on effect of IRC law on profitability

Category	**Frequency**	**Percentage**
Yes	47	98%
No	1	2%
Total	**48**	**100%**

Source: Author (2017)

Figure 4. 11 Analysis on 1st quarter profitability



Source: Author (2017)

From the analyzed data in the table 4.11 and figure 4.11 above, it is notable that 98% participants of the bank staff agreed that profitability had reduced since introduction of the IRC law.

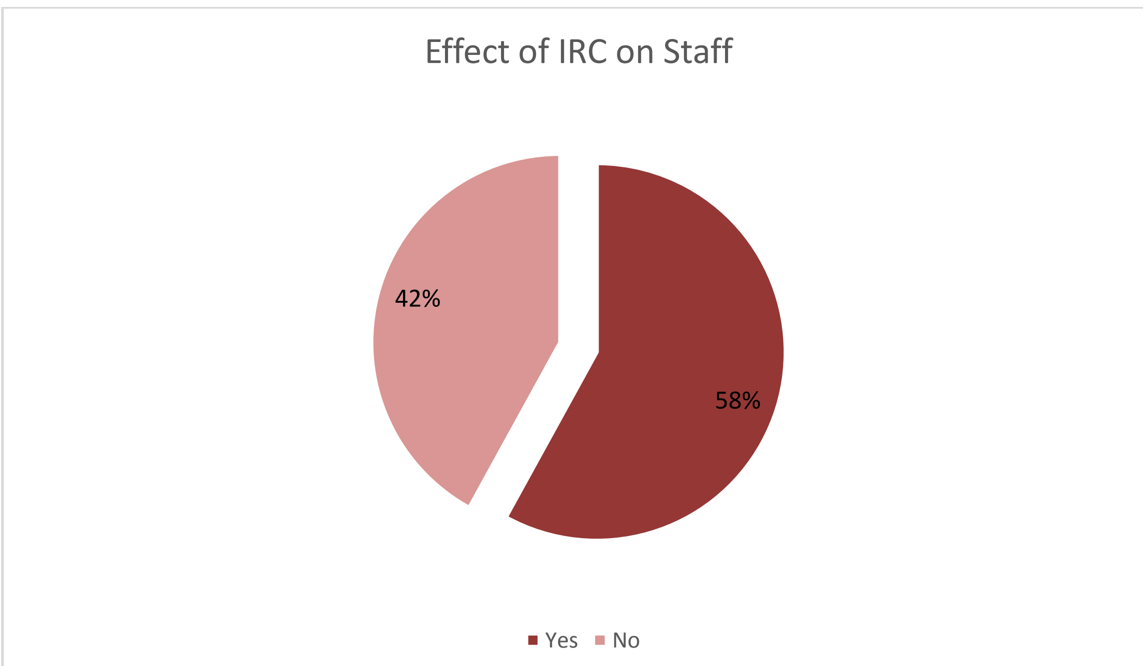
4.3.9Have you had any staff layoffs since the year began that can be associated to IRC law?

Table 4. 12 Response on effect of IRC on staff

Category	**Frequency**	**Percentage**
Yes	28	58%
No	20	42%
Total	**48**	**100%**

Source: Author (2017)

Figure 4. 12 Analysis of Effect of IRC on staff



Source: Author (2017)

From table 4.12 and figure 4.12 above when asked about knowledge of any staff who had been laid off since the beginning of the year and if they would associate such layoffs with effect of IRC law, 58% said they had witnessed layoffs that could be well associated to the IRC law while 42% of the staff said the layoffs were not as a result as IRC law but were probably caused by other factors within the bank such as natural layoff and indiscipline issues not necessarily IRC.

4.4 Presentation of findings from Equity bank customers

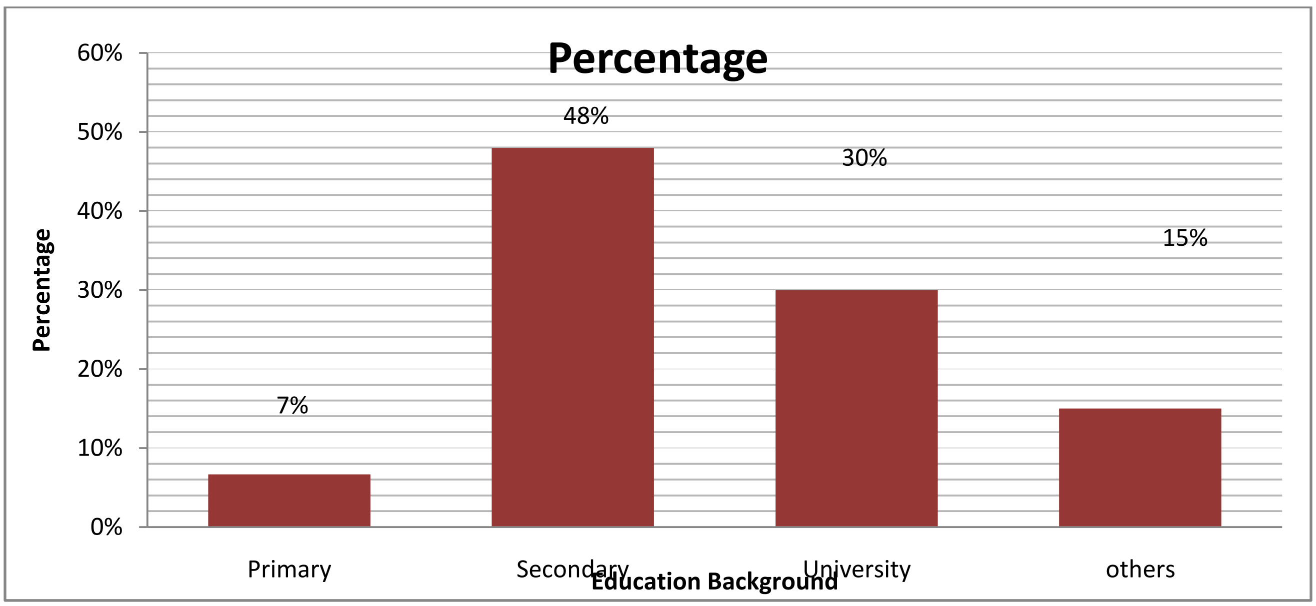
4.4.1 What is your education background?

Table 4. 13 Education background of the customers

Category	Frequency	Percentage
Primary	2	7%
Secondary	13	48%
University	8	30%
Others	4	15%
Total	**27**	**100%**

Source: Author (2017)

Figure 4. 13 Analysis of education background of the customers



Source: Author (2017)

According to table 4.13 and figure 4.13, 48% of the respondent customers have attained secondary level of education, 30% had gone further to acquire university level, another 15% had other technical skills while only 7% of the people interviewed had up to primary level of education. This shows that majority of the participants had good understanding of the questions and had knowledge on emerging issues in the economy.

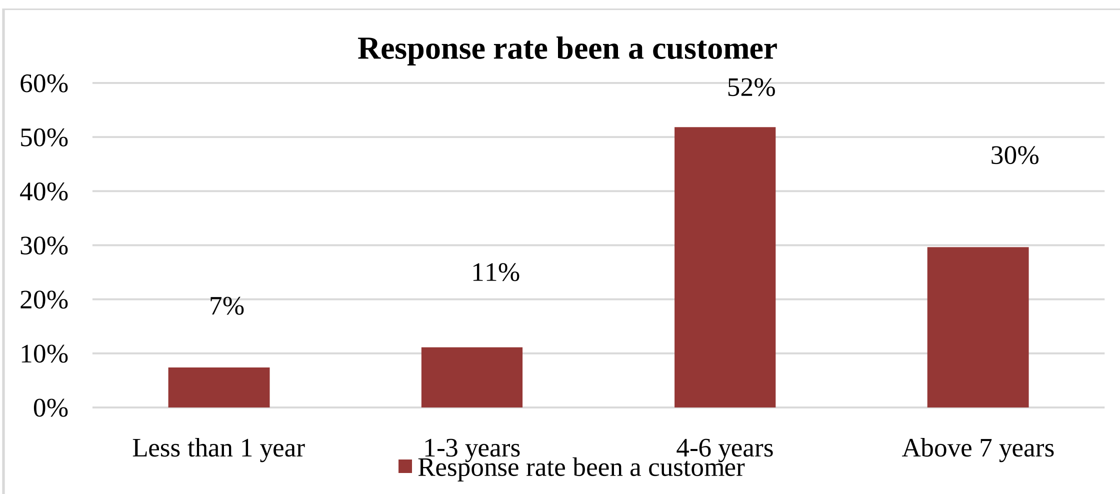
4.4.2 How long have you been an account holder with Equity bank?

Table 4. 14 Period customers have been Equity customers

Category	Frequency	Percentage
Less than 1 year	2	7%
1-3 years	3	11%
4-6 years	14	52%
Above 7 years	8	30%
Total	**27**	**100%**

Source: Author (2017)

Figure 4. 14 Analysis participants have been Equity bank customers



Source: Author (2017)

From table 4.14 and Figure 4.14, 7% of the respondents have been customers with Equity for less than a year, 11% of the respondents had the account for a period between 1 – 3 years, 52% of the respondents were in the range of 4 – 6 years and the remaining 30% had 7 years and above of account holding. It is evident therefore that majority of the participants have been with the bank for over 4 years hence have a good understanding of Equity bank.

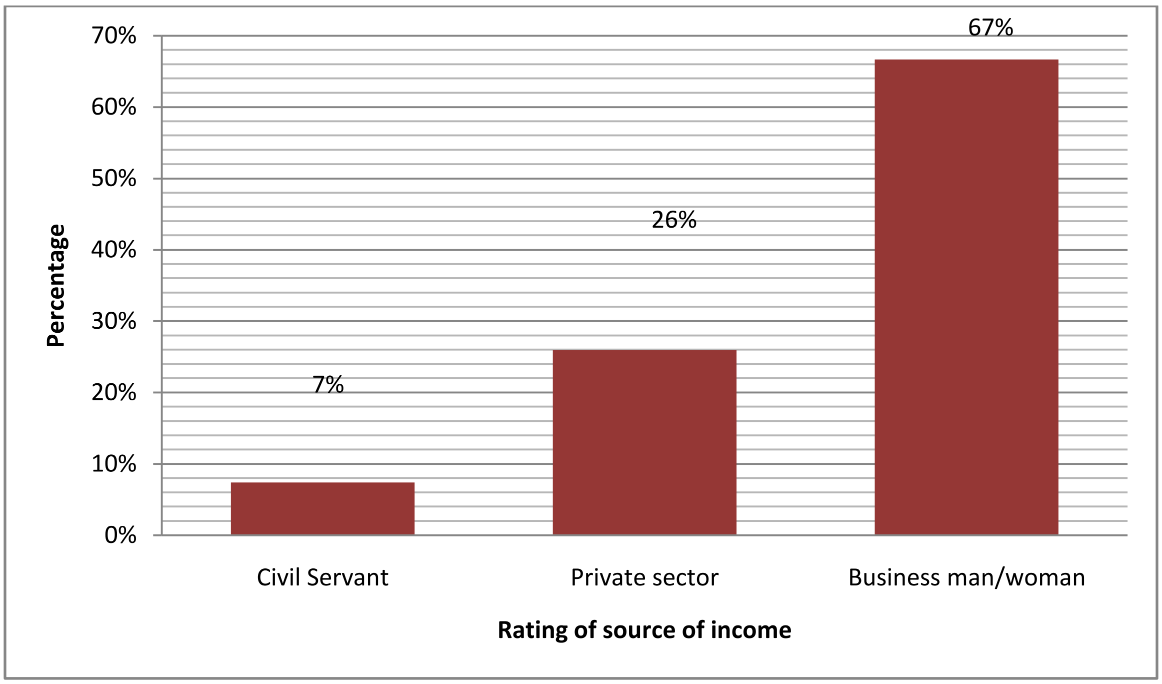
4.4.3What is your main source of income?

Table 4. 15 Source of income of the customers

Category	Frequency	Percentage
Civil servant	2	7%
Private sector	7	26%
Business man/woman	18	67%
Total	**27**	**100%**

Source: Author (2017)

Figure 4. 15 Source of income of the participants



Source: Author (2017)

Table 4.15 and Figure 4.15 above show the main source of employment of the respondents. According to the analysis, 7% of the respondents are in the civil service, 26% of them are in the private sector, while67% is either business men or women. This indicated that most of the respondents are business people.

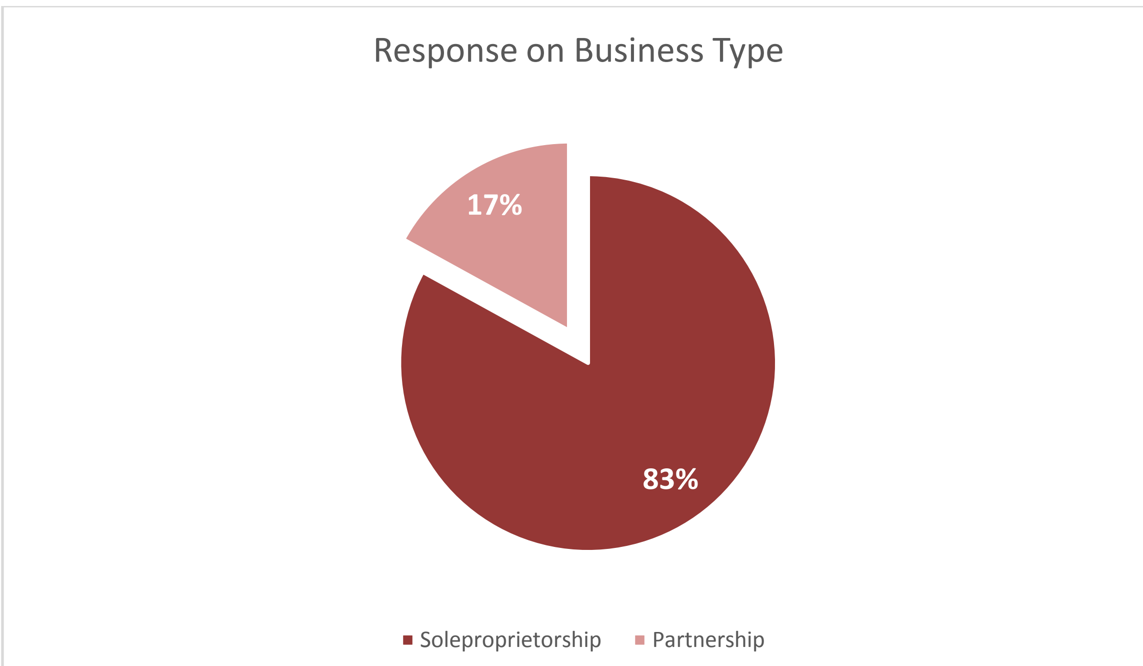
4.4.4 What Type of Businesses do you operate?

Table 4. 16 Type of businesses the customers operate

Category	**Frequency**	**Percentage**
Sole proprietorship	15	83%
Partnership	3	17%
Total	**18**	**100%**

Source: Author (2017)

Figure 4. 16 Analysis of the type of business



Source: Author (2017)

Table 4.16 and Figure 4.16 above show the category of the businesses of the respondents. According to the analysis, of the total number of the business people, 83% of them are sole proprietors, while 17% are in partnership businesses. This indicated that most of the respondents are self-employed.

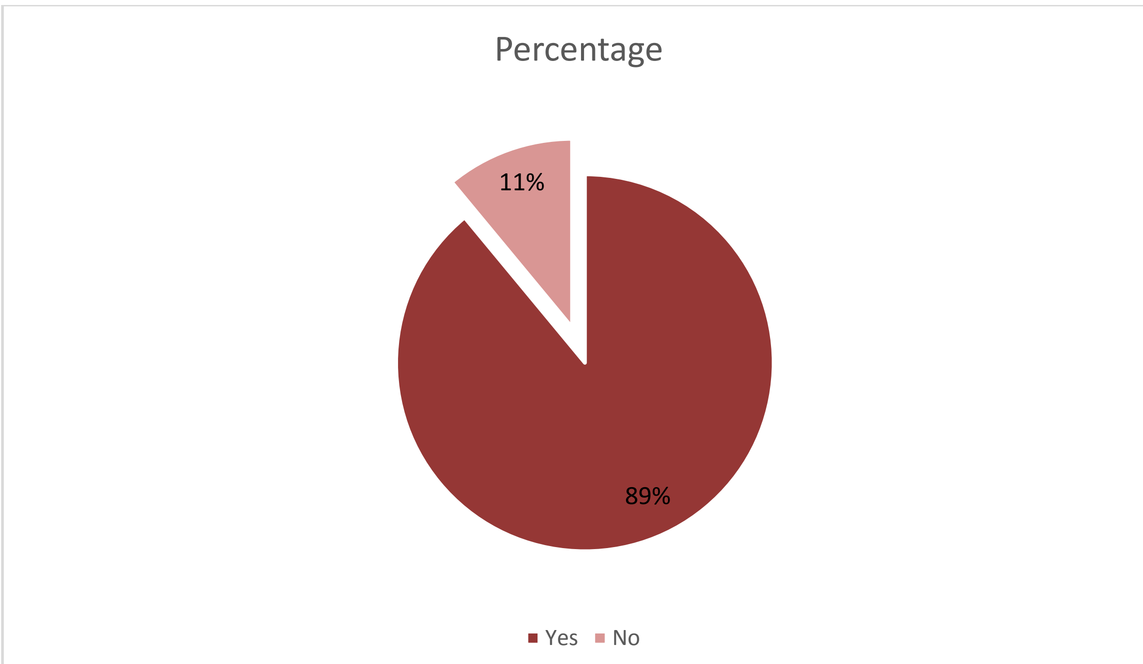
4.4.5 Have you obtained any form of loan before?

Table 4. 17 Customers response on past loan funding

Category	Frequency	Percentage
Yes	24	89%
No	3	11%
Total	**27**	**100%**

Source: Author (2017)

Figure 4. 17 Analysis of customers who have received loan funding from the bank



Source: Author (2017)

From the table 4.17 and figure 4.17 above, 89% of the customers stated that they had acquired loan at least once from their bank. 11% of the respondents however said they had not obtained any funding from their banks for certain reasons. It is therefore evident that majority of the customers seek financial assistance from the banks.

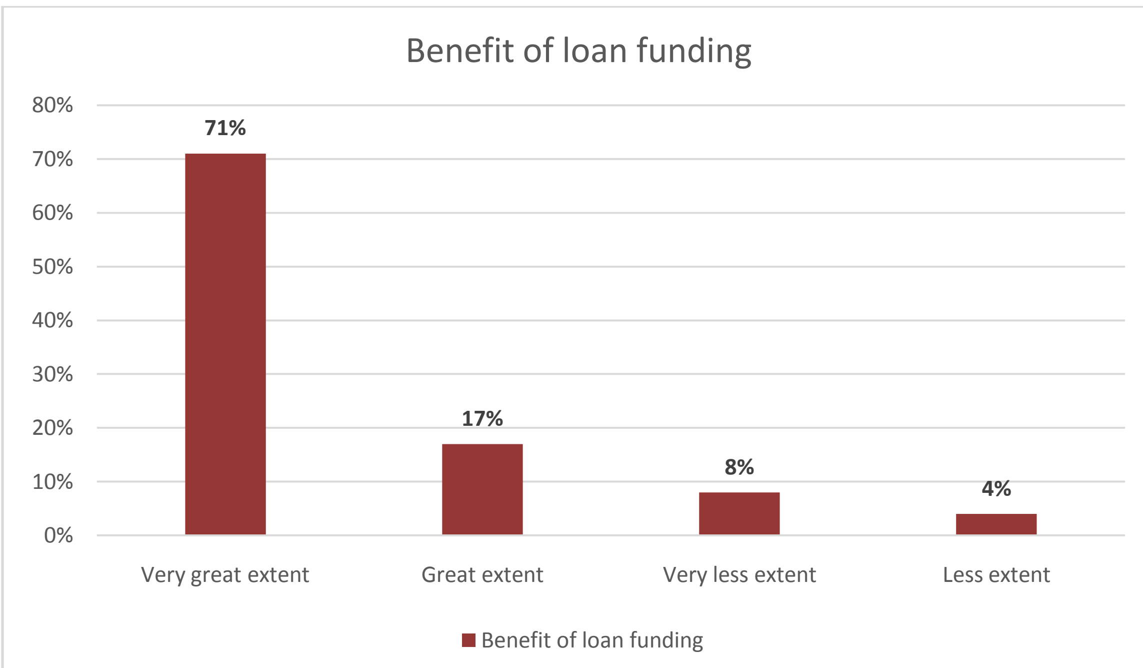
4.4.6 To what extent would you rate the benefit attained from acquiring the loan?

Table 4. 18 Extent to which customers benefitted from the loan fund

Category	Frequency	Percentage
Very great extent	17	71%
Great extent	4	17%
Less extent	2	8%
Very less extent	1	4%
Total	**24**	**100%**

Source: Author (2017)

Figure 4. 18 Analysis of the extent of benefit from loan



Source: Author (2017)

Table 4.18 and figure 4.18 above shows the extent the participants indicated they had benefited from receiving loan funding from the bank. 71% stated they had benefited very greatly, 17% indicated they had benefited greatly while only 12% stated they had little benefit from the loan they received. It is therefore clear that majority of the participants benefitted from the loan they received.

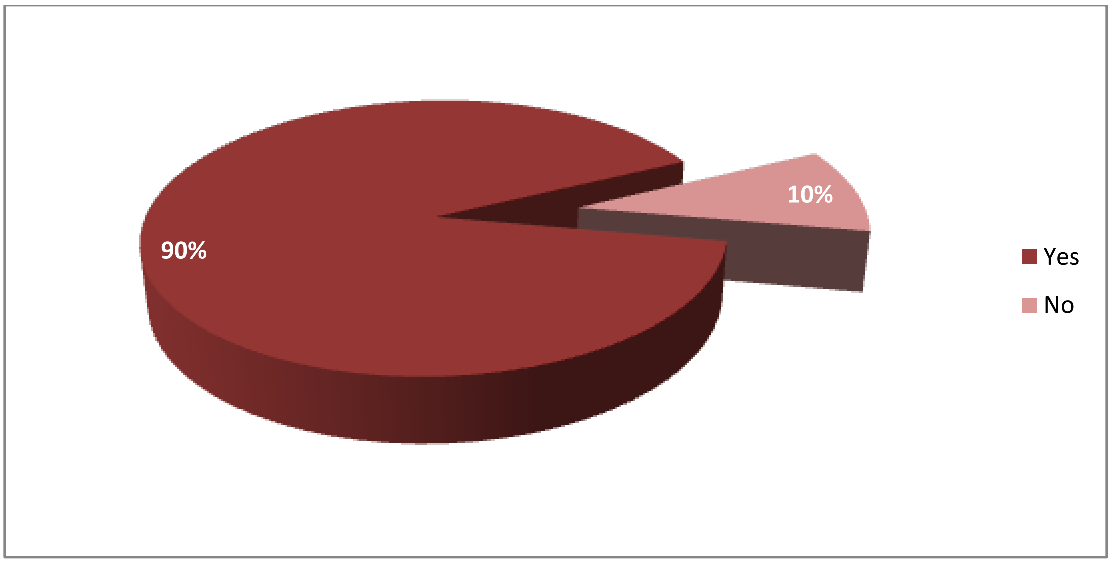
4.4.6 Do you think the recent introduced interest rate affects loan accessibility negatively?

Table 4. 19 Customers response on whether interest rate law charged will negatively affect loan accessibility

Category	Frequency	Percentage
Yes	24	90%
No	3	10%
Total	**27**	**100%**

Source: Author (2017)

Figure 4. 19 Analysis of effect of IRC on loan accessibility



Source: Author (2017)

Table 4.19 and Figure 4.19 above show the opinions of the customers on how negatively the law has affected their ability to access funds from the banks. Based on the analysis, majority of the customers at 90% agreed since introduction of IRC they are not accessing loans they apply for from their bank although the interest rate have been reduced through capping, this they argued was because the banks have reduced on lending especially to high risk businesses. Only 10% of the respondents indicated that the law had affected loan accessibility positively.

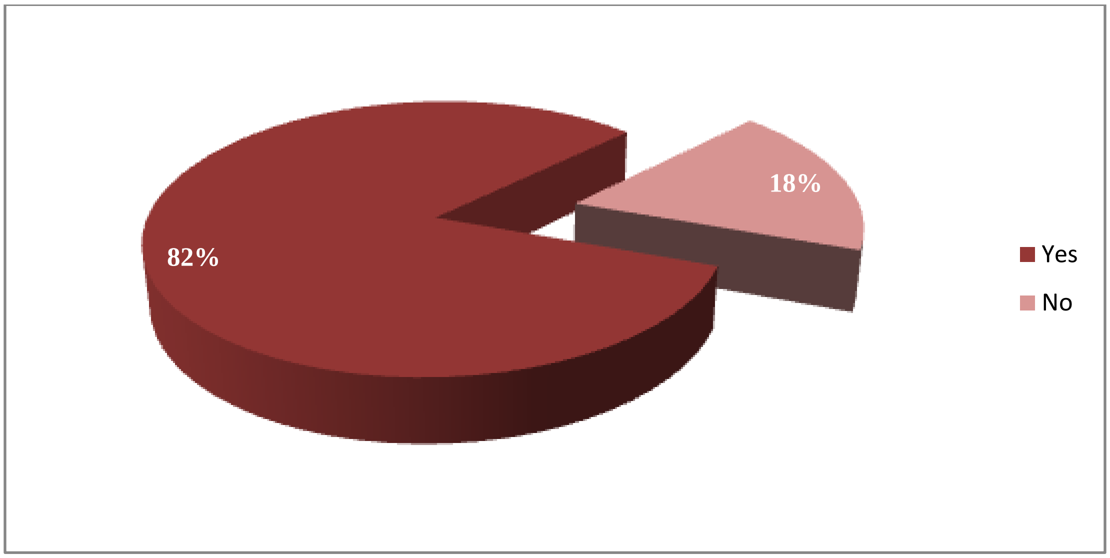
4.4.7 From observation, do you think capping interest rate has contributed to reduced workforce in the banks?

Table 4. 20 Effect of IRC on workforce

Category	Frequency	Percentage
Yes	22	82%
No	5	18%
Total	**27**	**100%**

Source: Author (2017)

Figure 4. 20 Analysis of effect on the workforce



Source: Author (2017)

Table 4.20 and Figure 4.20 above show the effect of interest rate on the workforce. According to the customers the researcher interviewed, 82% argued that they had seen a reduction in the number of staff serving them at the tellers hence; they may have been laid off. In their own sectors, the business people argued that they had to reduce on the workforce to counter operation costs arising because of trickle down effects of the interest rates. From the analysis, 82% of the respondents indicated that interest rate had an indirect effect on the workforce layoffs while 18% of the respondents indicated that the layoffs happening was a result of other factors not necessarily related to interest rate capping. It was therefore found out that indeed interest rate capping had an effect in workforce in the sector.

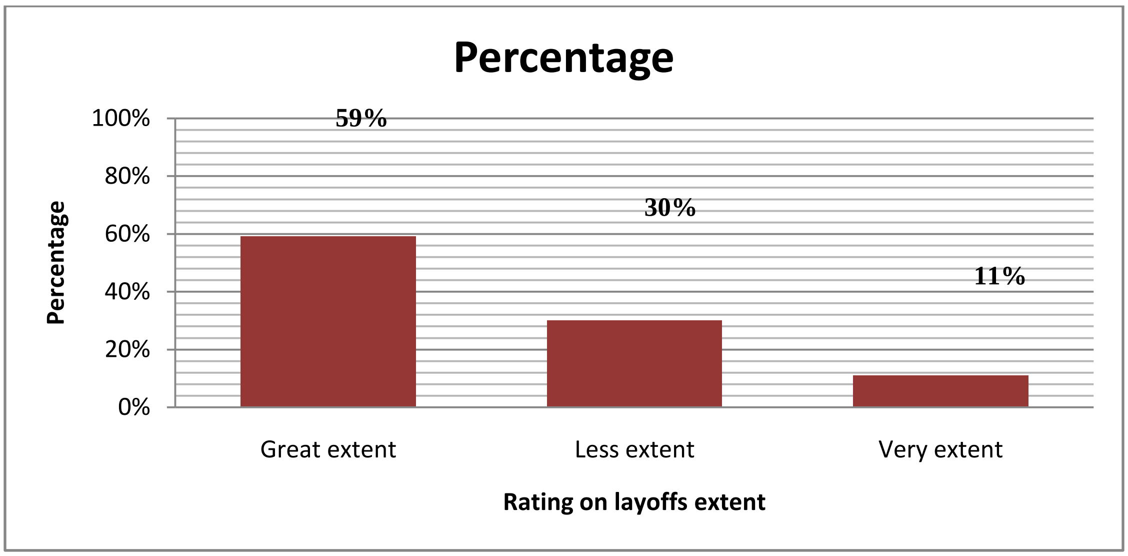
4.4.8 To what extent does interest rate charged determine your credit borrowing?

Category	Frequency	Percentage
Great extent	16	59%
Less extent	8	30%
Very less extent	3	11%
Total	**27**	**100%**

Table 4. 21 Extent interest rate law has negatively affected the staff

Source: Author (2017)

Figure 4. 21 Analysis of extent the interest charged has on credit borrowing



Source: Author (2017)

Table 4.21 and Figure 4.21 above shows the extent at which interest rate law has negatively affected the bank staff. According to the study analysis, it was found out that, 59% of the respondents rated the extent on staff layoff following interest law capping as great, 30% of them rated the extent as less, while 11% of the respondents argued that the interest rate law will have minimal negative effect on staff compared to other factors while making the decision to layoff.

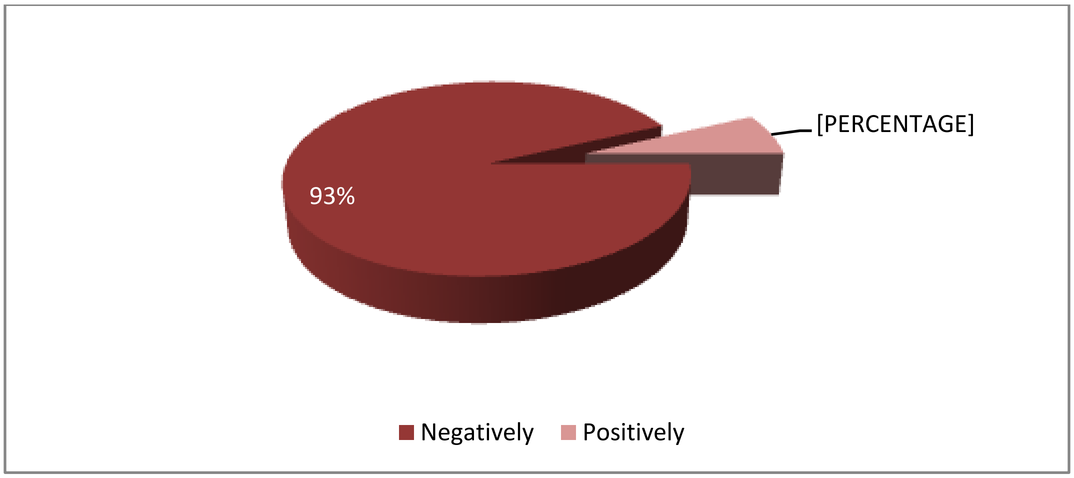
4.4.9How in your opinion will capping interest affect mortgage accessibility?

Table 4. 22 Effect of the law on mortgage loan accessibility

Category	Frequency	Percentage
Negatively	25	93%
Positively	2	7%
Total	**27**	**100%**

Source: Author (2017)

Figure 4. 22 analysis of effect of IRC on mortgage accessibility



Source: Author (2017)

Table 4.22 and Figure 4.22 above show the direction the effect of interest rate capping will have on mortgage accessibility. Based on the analysis, 93% of the respondents indicated that since mortgage loan is a long-term undertaking without income generation it will be affected negatively through loan rejection by the banks. Arguably, 7% of the respondents stated that mortgage accessibility may gain positively from the law on capping since it is a long-term investment and the facility is usually considered the collateral by the bank hence has a low risk. However, majority of the respondents at 93% are of the view that there will be a negative effect on mortgage accessibility going forward after the law.

4.4.10 Do you face any challenges with loan application since introduction of the IRC law?

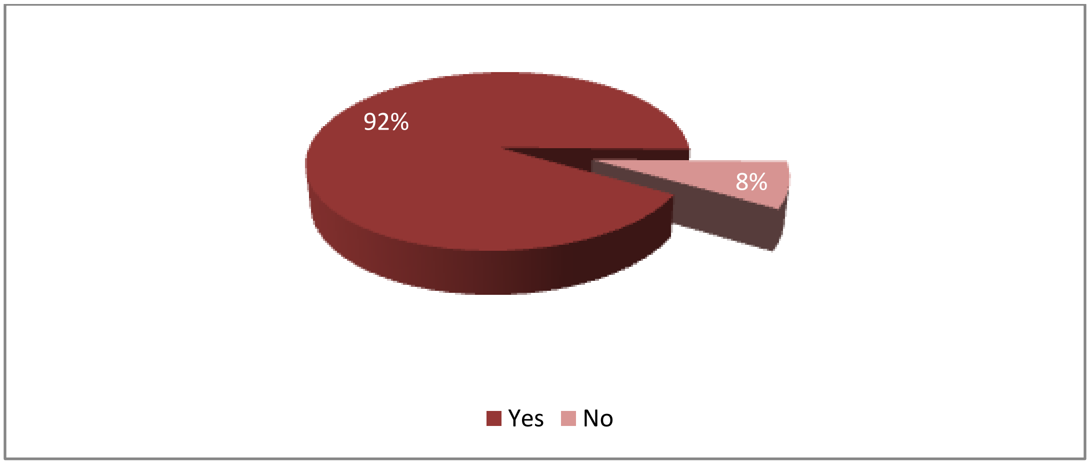
Table 4. 23 Customers response on challenges since introduction of the law

Category	Frequency	Percentage

Yes	25	92%
No	2	8%
Total	**27**	**100%**

Source: Author (2017)

Figure 4. 23 analysis of challenges with loan funding since introduction of the law



Source: Author (2017)

Table 4.23 and Figure 4.23 above shows the customers experience on loan application since the introduction of interest rate capping law. Majority of the customers i.e. 92%, claim that they have experienced several challenges while seeking credit funding from their banks ranging from rejected applications, delayed approvals, reduced amounts being approved, strict terms and conditions as well as lack of transparency on certain fees charged on loans. From the analysis therefore, it is evident that many customers at 92%are facing different challenges while applying for loans since introduction of the law.

4.5 Summary of Data Analysis

4.5.1 General Information

The target population of the researcher was a total of 96 respondents who were issued with questionnaires but the total number of questionnaires received from respondents was 75, meaning 21 questionnaires were either lost or misplaced by the respondents hence were never received for data analysis. This is a representation of 78 % of responses compared to 22% who did not respond. 78% was therefore the highest response rate. Majority of the respondents were male comprising of 57% of the total response rate while the female respondents accounted for 43%, this was evident that there were more male participants than females in the study.

Concerning the age of respondents who participated in the study, only 1% of the respondent was below 20years and was a staff of Equity bank. 32% of them were between 21 – 30 years old, 55% were between 31 – 40 years old, 9% were between 41 – 50 years old while 3% were between 51-60years. None was above 60 years. This show that majority of the total respondents were between 31 – 40 years. The researcher didn't request for the level of education from the staff because it was obvious that they must have attained above secondary level, but the customer respondent's education background indicated that 7% of the respondents had primary level of education, 48% of them had attained secondary level, 30% of them had university degree while the remaining portion of 15% specified other qualifications such as technical qualifications. The respondent's source of employment indicated that 7% of the respondents were working as civil servants, 26% of them stated that they were working in the private sectors, while the remaining 67% of the respondents were either business men or business women. This therefore indicates that most of the bank customers are business people. From the data analysis collected from the customers, majority of the respondents had been Equity bank customers for a period exceeding 4 years which clearly indicates that most of them understands major functions and operations of their bank branches.

4.5.2 Loan

Whether self-employed or working for someone, one unchanged fact in any organization is the need for finance. Budgets should be well set to allocate resources fairly well to meet the needs of the organization. The issue of finance can never be left out when planning in the organization. This is because it is hard for activities to be carried out without money. When there is need to acquire more resources, or to expand the business, people look for finances from their financiers through loans. Table 4.17 and Figure 4.17 represent the number of customers who claimed they had applied for loans from their bank for varying reasons. 89% of the respondents indicated they had borrowed from the bank more than once while 11% stated that they had not acquired any form of loan. This proved that loan financing was greatly sort for by the respondents and denying them this service would affect their businesses negatively. This is clearly outlined in table 4.18 and figure 4.18 where 90% of the customers agreed that they were finding it difficult to get loans since the introduction of the IRC law pushing them to adopt to other measures of reducing operation costs such as laying off the staff as indicated in table and figure 4.19.

4.5.3 Profitability

While looking at performance measures in a financial institution, profitability is usually considered one of the measures and based on the findings 96% of the respondents felt that bank performance has been negatively affected by the recently introduced law, while only 4% indicated that bank performance has been affected positively by the law. In relation to the bank performance, the researcher asked the staff whether the reported reduction in profitability of the banks 1st Quarter could be associated to the interest rate capping and 98% of the respondents stated that it was highly to blame. The argument was that banks major source of income comes from interest earning and since the banks had reduced their lending, the income was highly affected. 98% was a high response rate and it was found necessary before introducing such laws to first understand their consequences both short term and long term as a policy with an aim to fairly consider every sector in the economy. Data analysis helped to establish the rating of the extent the capping had on bank profitability which was found to be great at 96%.

4.5.4 Staff layoffs

In financial institutions, there must be some existing banking halls where customers need to visit for certain services. Although technology is reducing this numbers at a high rate it cannot be ignored at all. Staffs are a resource in any organization and increase the operation costs of the organization. The cost of maintaining staff is usually catered for from the banks income which as earlier indicated comes from the interest income. Table 4.12 and figure 4.12 represent data from staff on whether there had been any staff layoffs since the beginning of the year and if it could be associated to the IRC law. 58% of the respondents stated that there were layoffs because of IRC due to reduced interest income. 42% of the respondents however argued that the layoffs were not related to the law but to other factors such as natural layoff and low performance of the staff. When the researcher asked the customers whether they knew of any staff layoffs in the banks, 82% of the customers stated that they had noticed reduced number of teller staff since the beginning of the year while others argued that they had bank friends who were asked to take early retirement because of trickle-down effect of IRC among other factors. This proved that interest rate income had a profound relation to staff maintenance and compensation.

4.5.5 Mortgage uptake

Mortgage as a form of credit finance is usually given to those with a regular source of income which in many cases is normally pegged at an agreed amount on monthly bases. Being a long-term loan, the banks used to calculate their interest while considering the risk involved where there arise cases of loss of income. Considering the findings, 93% of the respondents are of the view that mortgage financing will be affected negatively for lack of flexibility on interest charges which was meant to cover the risks on mortgage financing. 50% of the respondents indicated a very high influence, 27% indicated a high influence while 23% indicated an average influence of the law on mortgage financing. Respondents advocated for other channels of protecting the consumer stating that the parliamentarians could have left the market forces dictate the rates, increased transparency in lending rates through publications of the rates while others stated that there could have been introduction of different rates for different loans.

CHAPTER FIVE

SUMMARY AND CONCLUSIONS OF THE FINDINGS

5.1 Introduction

This chapter, is in accordance to its objectives and seeks to present findings of the study, the summary as per the research questions and provide both a conclusion and recommendations deemed relevant and informative to the users of the research study.

5.2 Summary of findings

5.2.1 How does Interest rate capping affect profitability of the financial institutions?

According to the analysis, the researcher found out that majority of the respondents indicated that profitability of the bank had reduced notably since the introduction of the interest rate capping law with 96% of them stating that the reduction on profitability that was reported in the first quarter of the bank being as a result of the law. 4% of them however stated that the decreased profits were caused by other factors besides the law. It is however conclusive to say that IRC law largely contributes to a negative effect on bank's profitability.

5.2.2 How does loan lending and accessibility suffer from capping interest rates?

From the data collected, majority of the staff respondents at 82% stated that the banks had reduced on their lending services which had highly affected their loan portfolio as indicated in their financial reports. This was confirmed by the customers who the researcher interviewed with 90% of them saying as much as the interest rate had reduced, they were finding it hard to acquire credit financing from the banks with only 10% saying they didn't notice any changes to accessing funds due to mobile banking facilities. It was therefore concluded that IRC law had affected the loan portfolio of the banks negatively.

5.2.3 How does Interest rate capping translate to staff layoff in the financial institutions?

Based on the analysis, 58% of the staff stated that there have been staffs that have been laid off since the beginning of the year and they felt it was related to the declining profit which was as a result of IRC law. 42% of the respondents said there had been layoffs in the banks but they could not blame the law but other factors within the market. The study therefore concludes that capping interest rate reduces interest income in the bank leaving the banks with high operation costs hence the need to lay off some of the staff.

5.2.4 How does mortgage finance fluctuate with introduction of IRC law?

According to the analysis, 82% of the respondents stated that interest rate capping had negatively affected the mortgage financing meaning the banks were not willing to finance mortgage at such a low interest rate over a long period of recovery time. 18% felt that the effect on mortgage was positive since according to them many would apply the loan at a capped interest rate. It was found out that as much as interest was low and many were able to apply for mortgage financing, acquiring the funds was not easy since the banks had introduced strict conditions and requirements. This was the result of fluctuations noticed on the reports on mortgage finance.

5.2.5 To what extent does interest rate capping affect mortgage financing?

Based on the result finding, 78% indicated that mortgage financing would be negatively affected at a great extent, 18% felt the effect was less while 4% stated that they felt there would be very less effect on mortgage after IRC law. It was concluded that 78% was high and therefore there was a big likelihood that mortgage financing would be affected greatly by introduction of the law.

5.3 Conclusion

This study was investigating the impacts of interest rate capping on financial institutions with its main variables being; profitability of the bank, loan portfolio of the bank, staff layoffs in the banks and lastly mortgages variations as a result of capping in the banks.

The study concludes that while the major intention of capping interest rate is to support the macro economic objectives, it may end up putting pressure on banks net margins which are key to the bank's profitability. Profitability as a measure of performance is seen to decline from reduced uptake of loans as per the study findings, which usually yields income interest for the banks as well as from reduced income emanating from high interest paid on deposits. Reduced interest income may mean more liabilities than assets hence negatively affecting the net margin of the bank. Consequently, ROI needs to be higher than the interest paid on the investment which in the case of capping interest rate it's capped at 14%, while the interest paid on deposits has been capped at 7%.

Loan portfolio as described earlier is the money that the lender is owed and usually is listed as assets in the books of accounts. Since loan portfolio depends on interest rates earned, and the credit worthiness of the loan it plays a major role in measuring a bank's performance at any given time. From the study findings, due to introduced ceilings, the banks have reduced on their lending and this means there has been a decline in interest earned on loans and since loan portfolio is an asset by itself, the banks are facing major setbacks in managing their liabilities. When the bank is lending less of the money, then that means that there are more retained earnings in their books that are not being reinvested which may be subjected to central bank's deposits.

Laying off the staff may arise due to reduced income, or failure of the staff to meet set targets. From the study findings, there has been cases of staff who have lost their jobs due to declining profits that many respondents have indicated to arise from the interest ceiling. It is however important to note from the research study that while laying off the staff, the banks have had to compensate them which ultimately has increased their cost much further. Though it is long term strategy geared towards catering for cost in the future, where the staff are not happy with the exercise, some may turn to court cases which may again end up affecting the image of the company not to mention the costs that might be incurred during and after the court battles. It is important therefore for banks to consider this entire factor as much as they adopt to ways of dealing with ceiling to cut on the operation costs to try and mitigate on such risks.

Lastly mortgage is a long-term form of loan that is given to customers for purchase of housing facility. In investments, mortgage facility is taken as the collateral since no income is generated on the loan and where one defaults on their obligations, the bank has the first right of acquisition to compensate themselves. From the study findings, the respondents indicated that credit access to customers for mortgage purposes are being restricted, with respondents stating stringent measures as being introduced on those applying for such loans. Ceiling of interest therefore, have led to banks being cautious on mortgage financing because the interest being charged is low without future adjustments yet the risk involved is very high.

5.4 Recommendations

From the study findings, the following have been recommended;

On Profitability issue, the researcher recommends that the banks seek to ensure they encourage more customers towards mobile banking services because this will not only bring in income from interest on loans but there will also be a reduction on operation costs that are catered for via use of mobile services. Additionally, it is important for the banks to invest in agency baking services because this is a cost cutting strategy aimed at ensuring services are delivered to the customers at a cheaper and affordable way. Additionally, due to increased technology, it is advisable for the bank to close off some of their branches that are in close proximity to one another and especially those with lower income to mitigate on costs.

On the issue of loan portfolio, by increasing more mobile banking services, there will be a parallel increase in the number of people applying and accessing credit funding which will ensure that the assets of the banks are on the balance. To counter the risks on credit funding, the banks are required to ensure they keep communicating and update their listings with the credit rating bureaus (CRB) regularly to avoid cases of defaulters accessing more credit facilities. Additionally, it is important for the banks to look at their policies on credit funding and set rules and regulations that are friendly to their customers and that will protect them from risks of funding rather than denying the customers a platform to borrow funds from. The researcher also recommends that the CBK introduce a supervisory body to look into this matter as well as publicly make available published materials on approved charges and interest rate to be charged for the services.

From the study, it is evident that the banks have been laying off their staff as a cost cutting tool. The researcher recommends that the banks studies the market first to know whether it would be necessary to lay off and pay the cost herewith or decide on retaining the staff and assigning them other duties within the sector. The researcher also recommends that instead of laying off of the already trained staff, they retain them and instead opt on not hiring for some time.

The study found out that there have been difficulties accessing mortgage finance from the banks due to their long period of payment, the risk involved and the capped rate available. The researcher recommends that the CBK relooks at this capping policy and come up with a rate for each service which, will allow the banks to perform their duties successfully, and allow the customers to achieve the benefits intended.

5.5 Suggestion

The researcher admits that the study subject is very broad and cannot be fully covered by the four variables under this study. On this therefore the researcher suggests that further research be carried out with different variables and with other banks being the case study to fully understand on the impacts of capping rates of interest. Some of the suggested study areas include; effects of interest caps on small and medium enterprises, the role of interest rate capping in micro finance institutions and effects of interest rate capping on the foreign market while suggested variables include but not limited to emergence of illegal lenders following interest rate capping, and emergency of mobile banking towards a capped economy.

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APPENDICES

i. Customers questionnaires
ii. Staff questionnaires
iii. Introduction letter from school
iv. Plagiarism report

Appendix I

CUSTOMER QUESTIONNAIRE

Dear Respondent,

This questionnaire being administered is meant to collect data on the topic ‘’Impacts of Capping Interest Rate in performance of Financial Institutions; a case study of Equity Bank Nairobi CBD branches’’. You as a participant in the research are requested to provide honest information on the questions asked. Your responses are important and information thus provided will be strictly confidential and will be used only for the research purposes. Please complete this questionnaire in accordance to instructions given. Thank you for your cooperation.

Section A: (Equity Bank Customers)

Tick where appropriate

A) General Information

1. What is your gender?

a) Male ☐ Female ☐

2. Are you a resident of Nairobi County?

a) Yes ☐ No ☐

3. If No, where is your residence? …………....

4. What is your average age?

a) Less than 20 years ☐ b) 21-30 years ☐
c) 31-40 years ☐ d) 41-50 years ☐
e) 51-60 years ☐ f) Above 60 years ☐

5. Marital status

a) Married ☐ b) Single ☐

b) Widow(er) ☐ d) Separated ☐

6. Education background?

a) Primary level ☐ b) secondary level ☐ c) tertiary level ☐ d) others……………

7. What is your occupation?
   a) Civil servant ☐ b) Private sector worker ☐

   c) Businessman /woman ☐

   ii) If your answer above is c), what kind of business is it?

   a) Sole proprietorship ☐ c) Limited liability company ☐

   b) Corporation ☐ d) Partnership ☐

8. Are you an Equity bank customer? Yes☐ No☐
9. If yes, how long (whole number) have you been Equity Bank customer?
   a) Less than 1year ☐ b) 1-3 years ☐
   b) c) 4-6 years ☐ d) 7 and above☐

B) Loan funding

10. Have you obtained any form of loan before? Yes ☐ No☐ if yes, when? ………....and what kind of loan was it?
    Eazzy mobile loan ☐ Banking hall application ☐
    a) How many times have you obtained the Eazzy mobile loan?
       Once ☐ Twice ☐ More than twice ☐ None ☐
    b) How many times have you obtained the banking hall application loan?
       Once ☐ Twice ☐ More than twice ☐ None ☐

11. What was the purpose of the applied loan?
    Startup business ☐ Business expansion ☐ Education ☐

    Personal use ☐ Mortgage ☐ medical ☐

12. Did you obtain the amount applied for?
    Yes ☐ No ☐ If No, what reason was given ………..
    …………………………………………………………………………………………
13. How long did it take to obtain the loan? ………………………………………………
    ………………………………………………………………………………………
14. How would you rate the duration taken and the terms given?
    Satisfactory ☐ Non-satisfactory ☐
15. In your own observation was the rate given; Low ☐ Fair ☐ High ☐ Very high ☐
16. Were the terms given honored? …Yes ☐ No ☐

17. If No, explain briefly

……………………..……….

………………………………………………………………………………………………

18. Did you clear within the time span given? Yes ☐ No ☐

19. If No, what prevented you from paying the amount according to the agreed schedule?

………...

…………………………………………………………………………………………………

……………………………..

20. What action did the bank take in regard to the outstanding loan?

…………………….…………………………………………………………………………

……………………………………………………………………………………………...

21. How would you rate the action taken?

Good ☐ Fair ☐ Bad ☐

22. Would you advise other customers to borrow from the bank? Yes ☐ No ☐

If No, explain……………………………………………………………………………….

23. To what extent does the interest rate charged determine your credit borrowing?

Great extent ☐ less extent ☐ very less extent ☐ none ☐

24. How would you rate the credit provision in the bank currently?

Best ☐ Good ☐ Fair ☐ Bad ☐

25. Do you think the current rate of interest rate has an impact in loan accessibility for you? Yes ☐ No ☐ Explain briefly ……………………………………………………………

……………………………………………………………………………………………….

26. Have you heard about interest rate capping law in Kenya?

Yes ☐ No ☐

C) Staff Layoff

27. From observation, do you think capping interest rate has contributed to reduced workforce in the banks?

Yes ☐ No ☐

(ii) To what extent do you think the staff will be negatively affected by the IRC law?

a) Great extent b) less extent c) very less extent

D. Mortgage financing

28. How in your opinion, will capping the rate affect mortgage accessibility?

Negatively ☐ Positively ☐

ii) To what extent will interest rate capping affect Mortgage accessibility in relation to (i) above?

a) Great extent b) less extent c) very less extent

29. To what extent do you think capping rate will enhance loan accessibility to customers?
a) Great extent b) less extent c) very less extent

30. Do you agree there will be improvement in loan repayment following the interest law capping?
a) Strongly agree b) agree c) disagree d) strongly disagree

31. Do you face any challenges with loan application since introduction of the law of interest rate caps? Yes No

32. If yes, what are the challenges?

a) Lack of approvals
b) Delayed approvals
c) Small loans approved
d) Strict terms and conditions
e) Short repayment period
f) No transparency on interest rate charged
g) High interest rates

APPENDIX II

STAFF QUESTIONNAIRE

Dear Respondent,

This questionnaire being administered is meant to collect data on the topic ‘’Impacts of Capping Interest Rate in performance of Financial Institutions; a case study of Equity Bank Nairobi CBD branches’’. You as a participant in the research is requested to provide honest information on the questions asked. Your responses are important and information thus provided will be strictly confidential and will be used only for the research purposes. Please complete this questionnaire in accordance to instructions given. Thank you for your cooperation.

Section A: (Equity Bank Staff)

Tick where appropriate

A. General knowledge

1. What is your gender?
   Male ☐ Female ☐
2. What is your average age?

a) Less than 20 years ☐ b) 21-30 years ☐

c) 31-40 years ☐ d) 41-50 years ☐

e) 51-60 years ☐ f) Above 60 years ☐

3. Name of the branch …………….
4. Do you know about the recently introduced law on interest rate capping?
   Yes ☐ No ☐

B. Bank profitability

5. How in your opinion has the law affected the performance of the bank?
   a) Positively ☐ b) Negatively ☐
6. Do you think interest rate capping has contributed to the reduced profitability of the banks 1st quarter? Yes No ☐ ☐
   Briefly explain………………………………………………………………………………...
   ………………………………………………………………………….

C. Loan funding

7. How would you rate credit borrowing since introduction of the caps?
   a) Highly increased ☐ b) increased ☐
   c) Decreased ☐ d) highly decreased ☐
8. Which in your opinion has reported more of loan approvals?
   a) Mobile banking ☐ b) banking hall applications ☐

9. Who in your opinion are the major credit borrowers of the bank?
   a) Small scale enterprises ☐ b) Medium scale enterprises ☐
   c) Large scale enterprises ☐ d) Government ☐
10. To what extent in your opinion has loan accessibility been negatively affected by the law? a) great extent b) less ☐ent c) very☐ss extent ☐
11. Do you think interest rate affects loan repayment ability of the borrowers? Yes No
    Give a brief opinion…………………………………………………………………….
    …………………………………………………

D. Staff layoff

12. Have you had any staff layoffs since the year began? Yes ☐ No ☐ How, in your opinion has the trend been since IRC law? a) Highly increased increased decreased highly decreased……………………………………………
13. How would you rate the trend on performance of the bank now compared to the past years?
    a) Good ☐ b) Fair ☐ c) bad ☐
14. Do you sometimes fail to grant loans? Yes ☐ No ☐. Why ………………………….
    ………………………………………………………………………………………………
15. What action in your opinion do you think should have been/be taken rather than capping interest rates to protect customers?...
    ………………………………………………………………………………………………..

IMPACTS OF INTEREST RATE CAPPING ON PERFORMANCE OF FINANCIAL ISTITUTIONS

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